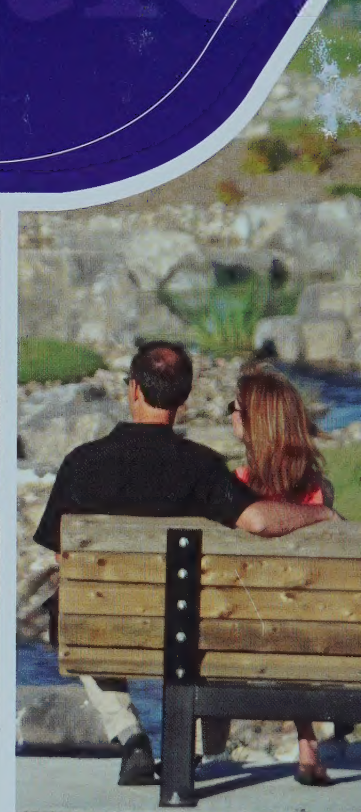
Communities

Melcor Builds Communities



MELCOR DEVELOPMENTS LTD.

Annual Report 2006



Corporate Profile

Our mission at Melcor is to be Alberta's premier real estate development and management company. We achieve this by continually striving to meet the needs of our customers, shareholders, fellow employees and business associates.

Melcor Developments Ltd. ("The Company", "Melcor") is primarily engaged in the following activities:

- the acquisition, planning and development of urban communities and the subsequent marketing and sale of single family, multiple family and commercial/industrial lots in Alberta in the metropolitan areas of Calgary, Edmonton, Lethbridge, Red Deer and in the City of Kelowna;
- the development of income producing properties in Alberta;
- the ownership and management of income producing properties in Western Canada; and
- the ownership and management of two championship golf courses in the Edmonton area.

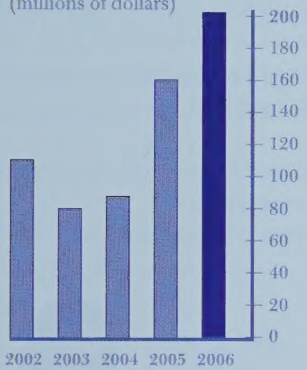
Table Of Contents

Message from the Executive Chairman 2
Message from the Vice President, Finance & Chief Financial Officer & Message from the President & Chief Executive Officer 3
Melcor's Current Developments 4
Board of Directors and Senior Management Team 6
Melcor Events 7
MD&A Table of Contents 8
Management's Discussion and Analysis 9
Corporate Governance Practices 29
Consolidated Financial Statements 30
Notes to Consolidated Financial Statements 33
Management's Responsibility for Financial Reporting 42
Auditors' Report 42
Five-Year Review 43
Performance Measures 44
Corporate Information 45

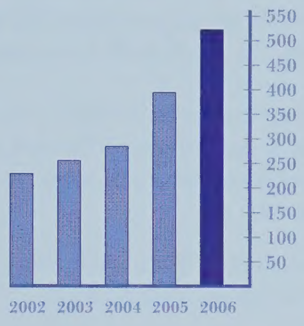
Financial Highlights

($)	2006	2005
Revenue	**203,402,000**	161,500,000
Earnings	**57,771,000**	41,776,000
Assets	**522,927,000**	396,113,000
Shareholders' equity	**235,910,000**	186,328,000
Per Common Share		
Basic earnings	**1.87**	1.38
Diluted earnings	**1.83**	1.35
Average share price	**17.90**	8.50
Dividends paid	**0.30**	0.25

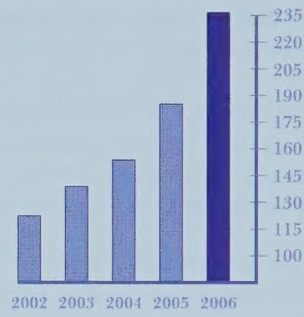
Revenue
(millions of dollars)



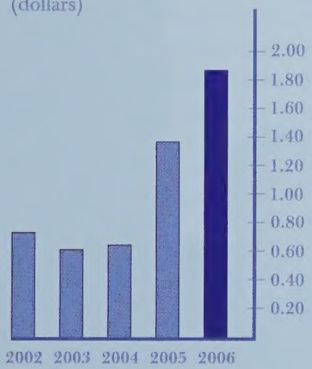
Assets
(millions of dollars)



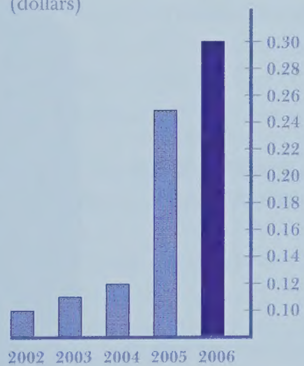
Shareholders' Equity
(millions of dollars)



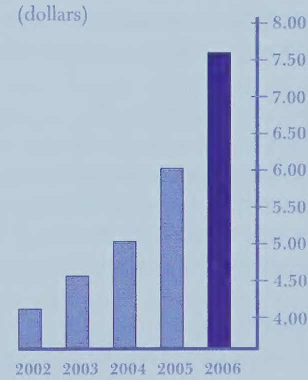
Earnings Per Share
(dollars)



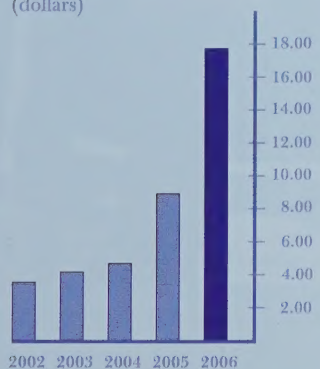
Dividends Per Share
(dollars)



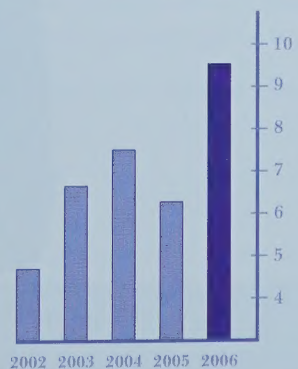
Book Value Per Share
(dollars)



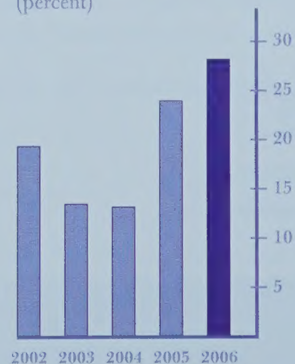
Average Share Price
(dollars)



Price Earnings Ratio*



Return on Equity*
(percent)



* See performance measures on page 44 for definitions on these calculations.

Message from the Executive Chairman

On behalf of the Board of Directors, I am pleased to report that 2006 was an excellent year for the company. Net earnings for the year were a record $57,771,000 or $1.87 per share compared to $41,776,000 or $1.38 per share in 2005. In addition to achieving record setting financial results, the company also continued its focus on creating long term value for its shareholders.

Planning for Continued Success

The Board of Directors is responsible to ensure that the company has in place a business plan and budget. The process involves consultation with management to discuss various relevant issues including the general business environment, plan assumption, appropriate levels of risk, and review and approval of business goals and detailed financial budgets.

I can report that management was successful in exceeding its planned operational and financial objectives in 2006. The record revenue and earnings achieved this past year were due in part to the strategic real estate that was acquired in past years. During 2006 the company's asset base was further enhanced with the acquisition of 1,300 acres of strategic lands for future development and through the development and acquisition of income producing assets.

Increased Dividends to Shareholders

Melcor has distinguished itself as a real estate development company whose objective is to provide Shareholders with an increasing dividend to provide a reasonable return on their investment. Dividends totalling $.30 per share were declared in 2006 compared to $.25 per share in 2005. Shareholders have benefited from the company's success through increased dividends over the past twelve consecutive years. This could really be said that it is the 18th consecutive year of increasing or maintaining dividend payments with the exception of 1995 where no special dividend was paid in that year whereas a special dividend was paid in 1994. Since 1969, the company has paid dividends in every year except for 1970, 1982 and 1988.

Board of Directors Succession

The company has been fortunate to have had the service of an excellent Board of Directors over the years. After serving on our Board of Directors for twenty years, Mr. Lou D. Hyndman will not be standing for re-election. His valued contributions to the company have been greatly appreciated and we thank him for his long service.

Also, after serving as a company Director for the past seven years, Mr. Bruce Saville will be retiring as well effective April 19, 2007. We thank him for the valuable contributions he has made to the company.

In terms of Board succession, we are pleased to report that Allan Scott, CEO of the Edmonton Economic Development Corporation and Catherine Roozen, Vice-President of Cathton Holdings Ltd., have agreed to be nominees for election as Directors at the Annual General Meeting.

Support to Our Community

In the year 2006 Melcor provided financial contributions to several charitable organizations, both in communities where we operate and to national causes. The Board of Directors is proud of the company's financial commitment to these charitable organizations and also of the volunteer efforts of our employees in enhancing our community.

Acknowledgement

The Directors recognize and express appreciation to management and staff for their continued outstanding contributions to the company's success and growth. I also thank Melcor's Board of Directors for their guidance, our customers and suppliers for their business and support, and our Shareholders for their continued confidence.

Sincerely,

Timothy C. Melton
Executive Chairman

Left - Right: Tim Melton – Executive Chairman, **Michael Shabada** – Vice-President, Financ and Chief Financial Officer, **Ralph Young** – President and Chief Executive Officer

Message from the President & Chief Executive Officer

Melcor has achieved another record year in 2006, thanks to the exceptional Alberta economy and the contributions of all of Melcor's stakeholders. The strong results reflect our management and staff's abilities to successfully create value in the development and management of our real estate assets for our clients and customers.

Melcor has continued its record financial performance for its shareholders resulting in an historic high trading value of $28.50 per share in late February 2007 and record dividends of $0.30 per share. The company has also continued to achieve an after tax return on equity of 27%, the highest level in recent years.

In 2006, Melcor continued to expand its financial and credit facilities to meet the demands of growth and high levels of land and commercial development. The Company also made significant positive acquisitions of land and commercial properties totalling over $65 million. Three new joint venture companies were initiated in 2006.

Melcor's management and staff have continued to perform at high levels. New staff have been added to achieve our activity levels and to ensure strong succession in future years. Approximately 50% of our management team are age 40 years or under.

Melcor's 2007 business plan calls for continued growth and corporate success. In addition to our Alberta assets, Melcor anticipates growth in Saskatchewan and British Columbia to participate in the economic growth in those provinces. We anticipate strong market conditions across western Canada over the next few years driven by strong commodity prices and strong employment growth.

In early 2007, Melcor achieved a significant milestone with the company's "Enterprise Value" (market capitalization plus liabilities) exceeding one billion dollars when the share price exceeded $24.00 per share.

I refer you to the Management Discussion and Analysis for a more detailed overview of operations and activities.

Sincerely,

Ralph Young

Ralph B. Young
President and Chief Executive Officer

Message from the Vice-President, Finance & Chief Financial Officer

Fiscal 2006 was Melcor's best year in the history of the Company in terms of revenue, earnings, asset growth and dividends paid. The Performance Chart on page 28 of this annual report illustrates Melcor's five-year cumulative total shareholder return, assuming an initial investment of $100 with all dividends reinvested versus the return on the TSX 300 Composite Index and the TSX Capped Real Estate Index. Over the past 5 years, the investment in Melcor has grown to $1,405 compared to the S&P/TSX Composite Index growth of $185 and the TSX Capped Real Estate Index growth of $217.

Assets and shareholder equity have grown to record levels and with the high level of earnings for the Company, both return on equity and return on assets (see performance measures at the back of the annual report) were at their highest level in many years.

The Company continues to have a strong relationship with its major lender and it endeavors to nurture relationships with other lenders. In light of the significant increase in the fair value of the Company's assets over the past several years, the Company has amended its approved debt to equity level from an upper range of 1.25 to 1 to 2.0 to 1. At December 31, 2006, our debt to equity ratio was 1.22 to 1. The Company's ability to service its debt continues to be very strong.

The Company was successful in raising capital from 3 fixed rate mortgages and from 2 variable rate project loans. In early 2007, we completed the fixed rate refinancing of two properties and plan to place new fixed rate financing on 2 expected acquisitions in the first quarter of 2007 and on up to three properties late in the year once leasing activities have been completed. We will also explore various options to improve the leverage ratio of our land held for future development and to work with our major lender to expand our short term financing ability by increasing our line of credit limits.

I would invite all shareholders and interested parties to review this annual report and related proxy materials and to contact me with any comments or questions regarding the information that is published herein.

Sincerely,

Michael Shabada

Michael D. Shabada, C.A.
Vice-President, Finance and Chief Financial Officer
Corporate Secretary

the Shores
WESTMERE ESTATES

Legacy—Ridge

CANYON CREST

The Manors
of Oakmont

BRIDGEPORT


Canyon Crest Community – Lethbridge

Oakmont Community – St. Albert

Legacy Ridge Community – Lethbridge


Kelowna Business Centre – Kelowna

Bridgeport Community – Leduc

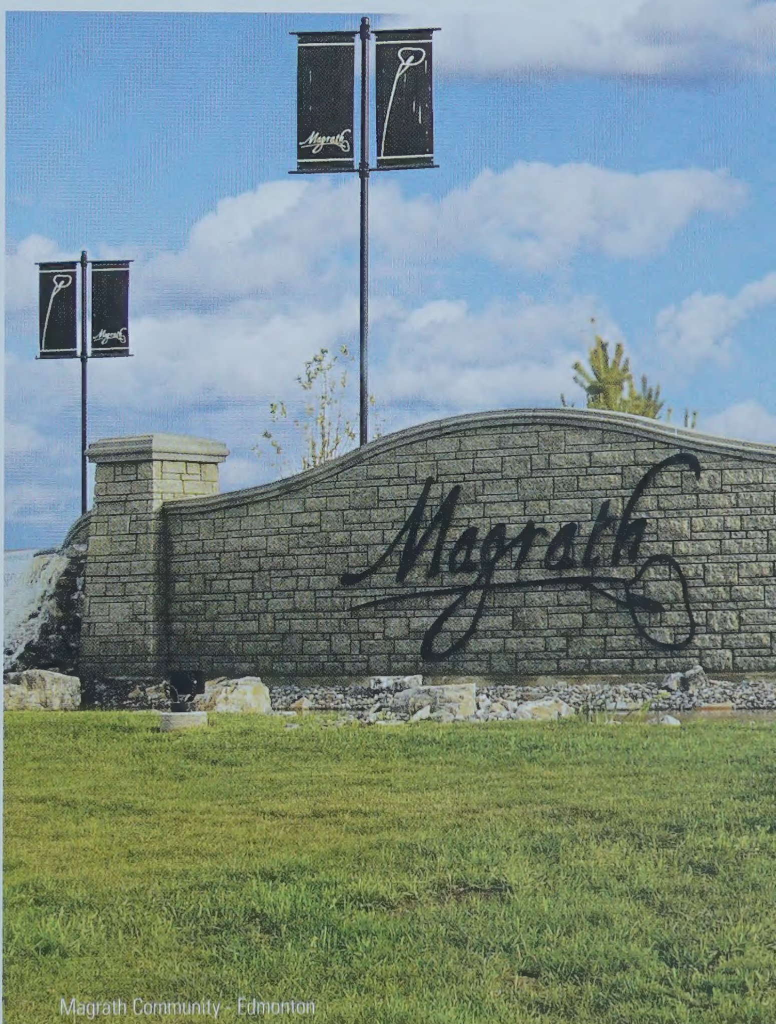
Vanier Woods

IRONSTONE
BY MELCOR DEVELOPMENTS

BLACK MOUNTAIN
GOLF • RESIDENCES • COMMUNITY

Magrath


Black Mountain – Recreational Property – Kelowna



Magrath Community - Edmonton

Board of Directors

Front Row (Left - Right)

William D. Grace - *Corporate Director*
Timothy C. Melton - *Executive Chairman, Melcor Developments Ltd.*

Back Row (Left - Right)

Ross A. Grieve - *President & CEO, PCL Construction Group Inc.*
Ralph B. Young - *President & CEO, Melcor Developments Ltd.*
Lou D. Hyndman - *Counsel, Field LLP Barristers & Solicitors*
Bruce Saville - *President, Saville Interest Group Inc.*
W. Garry Holmes - *Corporate Director*
Andrew J. Melton - *Partner, Avison Young Commercial Real Estate*

Senior Management Team

Front Row (Left - Right)

Karen Albarda - *Operations Controller*
Ralph B.Young - *President & CEO*

Back Row (Left - Right)

Michael D. Shabada - *Vice-President,* Finance & CFO
W. Peter Daly - *Vice-President, Land Development Division*
Timothy C. Melton - *Executive Chairman*
Darin Rayburn - *Vice-President, Investment Property Division*
Jon Goor - *Corporate Controller*
Brett A. Halford - *Vice-President, Administration*
Brian Baker - *Vice-President, Property Development Division*

Melcor Events

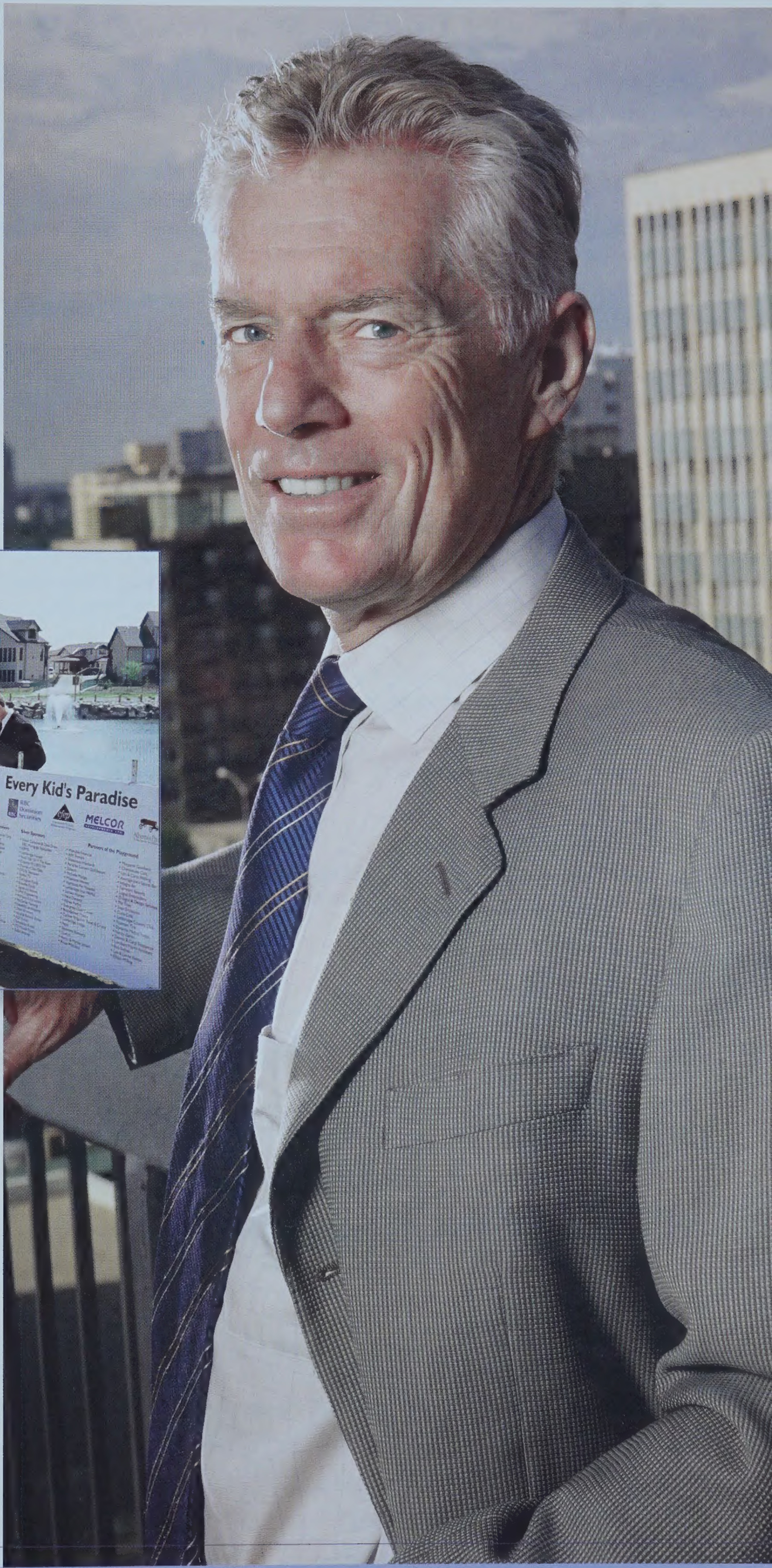
Timothy C. Melton >

Ernst & Young's 2006 Prairie Region Entrepreneur of the Year

On October 12, 2006, Melcor's Executive Chairman, Tim Melton received the prestigious **Ernst & Young 2006 Prairie Region "Entrepreneur of the Year"** award.

After being selected as the winner in the Real Estate category, which was one of the 12 categories, he was chosen for the overall Prairie Region award.

We at Melcor are extremely proud of his recognition.



Opening Ceremony ^

June 6, 2006 commemorated the opening of a "barrier free park", located in Melcor's Canyon Crest Community in Lethbridge, Alberta.

This type of park is the third of its kind to be built in Canada, which is designed to facilitate children and adults with disabilities, making the park accessible for all to enjoy.

Alberta's Premier, Ralph Klein, participated in the ceremony, along with Melcor, and the other contributors to the park (RBC Dominion Securities, Lombard North Group and the Province of Alberta).

Management's Discussion and Analysis – Table of Contents

Basic Activities	9
Mission Statement	9
Overall Performance	9
Results of Operations	9
Summary of Quarterly Results	10
Selected Annual Information	10
Corporate Risk	10
Community Development Operations	10
Sales Activity & Regional Highlights	11
Inventory	13
Land Holdings	14
Financing	14
Risk Factors	14
Property Development Operations	15
Sales Activity	15
Development Activity	15
Financing	16
Risk Factors	16
Investment Property Operations	16
Property Holdings	18
Property Transactions	19
Financing	19
Risk Factors	19
Recreational Property Operations	19
Operational Activity	20
Equipment/Assets	20
Financing	20
Risk Factors	21
Liquidity	21
Cash Flows	21
Capital Resources	22
Equity	22
Debt	22
Off Balance Sheet Arrangements	22
Letters Of Credit	22
Joint Venture Guarantees	22
Joint Venture Activity	23
Critical Accounting Estimates	23
Changes In Accounting Policies Including Initial Adoption	24
Disclosure Controls and Procedures and Internal Controls over Financial Reporting	24
Financial Instruments	25
Outstanding Share Data	26
Fourth Quarter Results	26
Non-GAAP Financial Measures	27
Assumptions For 2007 – 2009	28

The following discussion and analysis of the financial results and position of Melcor Developments Ltd. should be read in conjunction with the audited financial statements and notes to those statements for the years ending December 31, 2006 and 2005. The financial data provided has been prepared in accordance with Canadian Generally Accepted Accounting Principles. The Company's reporting currency is Canadian dollars. Certain statements in this discussion can be considered forward looking, and readers are cautioned that such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contained in these forward looking statements. These risks and uncertainties are described elsewhere in this discussion and in other regulatory filings.

Additional information including the Annual Information Form and Management Information Circular is available from SEDAR at www.sedar.com.

The balance sheet is presented without reference to current assets or current liabilities. The operating cycle of an entity involved in real estate investment and development is normally considered to be longer than one year. Thus, the concept of current assets and current liabilities is not considered relevant and there is no need to segregate the balance sheet to disclose assets or liabilities which are expected to be settled within the immediately following year.

Basic Activities

Melcor Developments Ltd. ("Melcor" or "the Company"), which traces its history back to 1923, has been a public company since 1968 and trades under the symbol "MRD" on the Toronto Stock Exchange. It has survived and prospered for over 80 years, due to stable and committed ownership and loyal and dedicated staff who are focused on the real estate industry. Melcor primarily operates in Alberta in the metropolitan areas of Calgary, Edmonton, Lethbridge and Red Deer. It also has assets in Kelowna (British Columbia), Regina (Saskatchewan) and in Arizona (USA). Its diversified operations include:

- the acquisition of raw land, which is held for future development until market conditions warrant the planning, servicing and marketing of urban communities which are then sold in the form of single family, multiple family and commercial/industrial lots;
- the development of income producing properties in Alberta;
- the ownership and management of income producing properties in Western Canada; and
- the ownership and management of two championship golf courses in the Edmonton area.

Mission Statement

Melcor's mission is to be Alberta's premier real estate development and management Company by successfully meeting the needs of our:

- Shareholders, partners and lenders;
- Customers and suppliers;
- Selves and fellow employees; and
- Communities.

Overall Performance

Results of Operations

Net earnings for the year were $57,771,000 compared to prior year earnings of $41,776,000. Basic earnings per share for 2006 was $1.87, a 36% increase over 2005 earnings per share of $1.38. Fiscal 2006 represents the highest earnings per share in the Company's history, primarily due to the results of the Community Development Division. The fourth quarter results represent the highest quarterly earnings per share in the Company's history (please refer to page 26 of this MD&A for 4th quarter commentary).

	Year Ended		Three Months Ended	
Financial Highlights ($)	**Dec. 31, 2006**	Dec. 31, 2005	**Dec. 31, 2006**	Dec. 31, 2005
Revenue	**203,402,000**	161,500,000	**85,891,000**	69,506,000
Earnings	**57,771,000**	41,776,000	**33,576,000**	15,386,000
Assets	**522,927,000**	396,113,000	**522,927,000**	396,113,000
Shareholders' equity	**235,910,000**	186,328,000	**235,910,000**	186,328,000
Per Share				
Basic earnings	**1.87**	1.38	**1.09**	0.51
Diluted earnings	**1.83**	1.35	**1.06**	0.50
Book value	**7.60**	6.06	**7.60**	6.06

Summary of Quarterly Results

Financial information for the prior eight fiscal quarters is as follows:

	Revenues ($000s)	Net Earnings ($000s)	Earnings Per Common Share Basic ($)	Diluted ($)
March 31, 2005	15,587	2,573	.09	.09
June 30, 2005	24,052	5,297	.17	.17
September 30, 2005	52,355	18,520	.61	.59
December 31, 2005	69,506	15,386	.51	.50
March 31, 2006	34,428	7,105	.23	.23
June 30, 2006	37,950	7,912	.26	.25
September 30, 2006	45,133	9,178	.29	.29
December 31, 2006	85,891	33,576	1.09	1.06

Selected Annual Information

($000s)	2006	2005	2004	2003	2002
Revenue	**203,402**	161,500	88,339	80,035	110,565
Earnings	**57,771**	41,776	19,437	18,406	23,089
Assets	**522,927**	396,113	282,348	251,702	231,795
Liabilities	**287,017**	209,785	128,807	110,965	105,284
Equity	**235,910**	186,328	153,541	140,737	126,511
($)					
Basic earnings per share	**1.87**	1.38	0.63	0.60	0.76
Diluted earnings per share	**1.83**	1.35	0.62	0.59	0.74
Dividends per share	**0.30**	0.25	0.12	0.11	0.10

Corporate Risk

The cyclical nature of the Company's business along with 90% of its assets being located in Alberta, may subject Melcor to greater risks than Companies that are more geographically diversified. Various factors which are not in management's control can impact the Company's business. These factors include:

- interest and inflation rates;
- general economic conditions in the regions in which the Company operates;
- population growth and migration;
- job creation and employment patterns;
- consumer confidence;
- pricing of input costs;
- competitor's strategies;
- government policies, regulations and taxation; and
- availability of financing for real estate assets.

Community Development Operations

The Community Development Division is responsible for the acquisition, planning, development and marketing of urban communities. Although the Division predominantly develops mixed-use residential communities, it also develops large-scale commercial and industrial centres in the Edmonton and Calgary regions. The majority of residential lots and parcels are sold to selected homebuilders that purchase sites through agreements for sale.

Strategic initiatives for 2007 – 2009 include:

- Acquire land inventory and improve the market share of Melcor, primarily in Alberta, and yield acceptable financial returns;
- Investigate further opportunities for expansion in western Canada and the south-western USA;
- Manage staff resources to facilitate the successful implementation of development activities; and
- Obtain major regulatory approvals in the Calgary Region (i.e. various area structure plans, annexations and advance the planning for a golf course and manufactured home community).

Operating Review

($000s)	2006	2005	2004	2003	2002
Revenue	**183,581**	149,246	75,359	72,556	101,422
Cost of sales	**(103,653)**	(79,723)	(43,830)	(42,259)	(62,567)
Net operating income (NOI)[1]	**79,928**	69,523	31,529	30,297	38,855
Interest revenue	**4,109**	1,449	1,545	2,130	1,569
Interest expense	**(935)**	(468)	(225)	(234)	(252)
	83,102	70,504	32,849	32,193	40,172
Administrative expenses	**(4,472)**	(3,938)	(3,260)	(3,198)	(3,746)
Divisional earnings	**78,630**	66,566	29,589	28,995	36,426

1 See "Non-GAAP Financial Measures" section

Selected Financial Benchmarks

($000s)	2006	2005	2004	2003	2002
Assets					
Agreements receivable	**127,178**	85,335	43,508	46,904	57,094
Land inventory	**255,570**	201,398	163,694	141,004	116,904
	382,748	286,733	207,202	187,908	173,998
Debt					
Bank debt	**29,599**	16,026	10,167	1,642	839
Provision for land development costs	**39,805**	29,026	18,962	15,072	13,763
Debt on land inventory	**72,440**	50,478	40,311	35,885	29,530
	141,844	95,530	69,440	52,599	44,132
Net investment	**240,904**	191,203	137,762	135,309	129,866
NOI as % of revenue [2]	**43.5%**	46.6%	41.8%	41.8%	38.3%
Divisional earnings as % of net investment [2]	**36.4%**	40.5%	21.7%	21.9%	31.5%
% of assets financed [2]	**37.1%**	33.3%	33.5%	28.0%	25.4%

2 See "Calculations" in "Non-GAAP Financial Measures" section

Sales Activity & Regional Highlights

a) Sales Activity

Total sales for the Division were $183,581,000 in 2006 versus $149,246,000 in the prior year. Overall, annual revenue was up by 23% and net operating income as a % of revenue was 43.5%. Excluding a material sale of $24,693,000, recorded in the third quarter of 2005, annual revenue for the Division increased by 47%. The Company sold 6% more lots and 205% more acres in the form of multi-family/commercial/industrial sites. During the year, twenty-nine subdivision plans were registered in 17 communities compared to thirty one subdivisions registered in 18 communities in the prior year.

	Twelve Months Ended December 31, 2006			Twelve Months Ended December 31, 2005		
	External Revenue (1)	**Units/Acres @ 100% (2)**	**Gross Average Revenue Per Unit/Acre (3)**	External Revenue (1)	Units/Acres @ 100% (2)	Gross Average Revenue Per Unit/Acre (3)
Single family lots	**138,643,000**	**1,775**	**97,400**	99,281,000	1,676	76,500
Multiple family sites	**19,282,000**	**42.0**	**512,000**	7,555,000	27.0	367,000
Commercial sites	**6,785,000**	**15.6**	**434,900**	1,702,000	5.5	339,200
Industrial parcels	**6,214,000**	**41.5**	**279,200**	-	-	-
Non-strategic parcels	**3,305,000**	**53.4**	**61,900**	5,013,000	247.8	24,300
Other land	**189,000**	**2.1**	**89,600**	27,231,000	178.4	152,700
Management fees & other	**4,173,000**			2,239,000		
	178,591,000			143,021,000		

(1) External Revenue excludes inter-divisional sales. (See Segmented Information note to Consolidated Financial Statements).

(2) Units/Acres are not prorated for joint venture interests.

(3) Gross average revenue per unit/acre is based on the inclusion of the joint venture participant's interests in both revenue and in the unit/acres sold.

Residential Lot Sale History

(including joint ventures at 100%)	2006	2005	2004	2003	2002
Edmonton	**844**	811	520	428	775
Red Deer	**466**	520	258	401	455
Calgary	**310**	260	199	325	504
Lethbridge	**140**	85	118	100	87
Arizona	-	-	13	4	-
Kelowna	**15**	-	-	-	-
	1,775	1,676	1,108	1,258	1,821

Subject to continuing strong markets, the Division as a whole is expected to perform at levels above its ten year average financial results. Results within individual regions, however, will vary due to:

- the nature of existing land holdings;
- timing of approvals; and
- success in completing strategic new acquisitions.

b) Edmonton Region

The Company has active developments in the Cities of Spruce Grove, Leduc and St. Albert as well as the south west and west end areas of Edmonton. In addition, the Company is planning to commence development in the south east area of Edmonton in 2007. The Region showed a 4% increase in lot sales. The primary reason for this increase is the strong demand for housing in the capital region as a result of strong economic activity.

The Division purchased 236 acres (net of joint venture interests) in Edmonton and 142 acres of land in Spruce Grove.

c) Calgary Region

The Company is active in the Town of Chestermere and the City of Airdrie, where most of the region's revenue has been realized in the past few years and is expected to continue over the near term.

During the year, the Company added 132 acres of land adjacent to the western boundary of the City of Calgary. This brings Melcor's contiguous land holdings to 519 acres in this area. Development activity could commence in 2009, provided that regulatory approvals are obtained as expected. In addition, the Company obtained exclusive ownership of 49 acres of land in Airdrie as a part of a land distribution from a Joint Venture.

d) Red Deer Region

The Company is primarily active in the Vanier Woods community in the south east part of the City of Red Deer. The Region had lot sales of 466 in 2006, down from 520 comparable sales in 2005. The primary reason for the decrease in lot sales is due to the timing of plan registrations.

In 2007, the Company expects to commence development of two new communities in the City of Red Deer.

The Company added to its land holdings by purchasing 89 acres in the City of Red Deer and 399 acres in the County of Red Deer, adjacent to the City of Red Deer. In addition, the Company purchased 216 acres (net of joint venture interests) of land in the Town of Sylvan Lake.

e) Lethbridge Region

The Company continues to be active in the north part of the City of Lethbridge in the Legacy Ridge community and in the south part of Lethbridge in a community called Paradise Canyon. The Company recorded 140 lot sales during the year, an increase of 65% over the prior year.

During the year, the Company purchased 85 acres of land in west Lethbridge. These lands, within the boundaries of the City of Lethbridge, are several years from development.

f) Kelowna Region

During 2006, the Company commenced sales in its Black Mountain residential community. As of the end of the 2006 year, 15 single family residential lots and 6 acres of multi family residential land had been sold within the development. The Company expects to continue development and sales in the Black Mountain residential community throughout the 2007 year.

The Company also purchased 5 acres of land immediately adjacent to the existing Black Mountain community.

g) Arizona Region

During the year, the Company sold all remaining developable lands in Arizona.

h) Summary

With housing markets in Alberta predicted to remain strong, it is expected that all regions where the Company operates, will continue with above average results. The Company is positioned to maintain or increase sales in all regions for 2007. The Company projects that sale prices will keep pace with rising input costs.

Inventory

Developed Inventory Carry Forward Schedule

Residential Lot Sale Inventory

(including joint ventures at 100%)	**2006**	2005	2004	2003	2002
At beginning of the year	**612**	779	677	613	859
New developments	**1,756**	1,509	1,210	1,322	1,575
Sales	**(1,775)**	(1,676)	(1,108)	(1,258)	(1,821)
	593	612	779	677	613

Multi-Family/Commercial/Industrial Site Inventory

(in acres - including joint ventures at 100%)	**2006**	2005	2004	2003	2002
At beginning of the year	**160**	92	80	79	55
New developments	**76**	122	49	60	56
Sales	**(109)**	(54)	(37)	(59)	(32)
	127	160	92	80	79

Undeveloped Inventory Carry Forward Schedule

Land Inventory

(in acres)	**2006**	2005	2004	2003	2002
At beginning of the year	**6,117**	6,159	5,659	5,197	4,290
Purchases	**1,305**	993	919	820	1,211
Sales	**(56)**	(426)	(146)	-	(17)
Developed	**(274)**	(609)	(273)	(358)	(287)
	7,092	6,117	6,159	5,659	5,197
Average cost per acre ($)	**22,800**	20,200	17,900	16,400	13,500

The acquisition of land inventory is based upon management's anticipation of market demand and development potential, primarily within five years. The average cost per acre has increased in each of the past five years because the Company has been purchasing lands that are more expensive than the cost of lands which it owns. Land purchases during the last five years are as follows:

Land Purchases

(in acres)	**2006**	2005	2004	2003	2002
Edmonton	**379**	353	465	261	285
Calgary	**132**	16	165	197	597
Red Deer	**704**	45	167	342	160
Lethbridge	**85**	203	122	-	50
Kelowna	**5**	376	-	20	119
	1,305	993	919	820	1,211

($000s)					
Land cost	**55,349**	29,774	22,749	26,066	34,230
Vendor financing	**(29,872)**	(13,035)	(12,395)	(13,596)	(10,286)
Net cash used for acquisitions	**25,477**	16,739	10,354	12,470	23,944

Land Holdings

Land Inventory by Region

	Developed Inventory			Undeveloped Inventory
	Residential Lots	Residential Acres	Commercial/ Industrial Acres	Acres
NORTHERN ALBERTA				
Edmonton	210	5	4	975
Spruce Grove	29	-	5	817
County of Parkland	-	-	-	726
Leduc	53	-	16	451
St. Albert	73	-	-	13
SOUTHERN ALBERTA				
Calgary	-	-	-	323
Airdrie	51	-	46	204
M.D. Rockyview	-	-	-	1,368
Chestermere	44	-	26	64
Lethbridge	76	-	-	483
CENTRAL ALBERTA				
Red Deer	-	-	-	284
County of Red Deer	-	-	-	742
Sylvan Lake	-	-	-	216
CENTRAL BRITISH COLUMBIA				
Kelowna	57	25	-	426
DECEMBER 31, 2006	593	30	97	7,092
DECEMBER 31, 2005	612	11	149	6,117

Undeveloped land inventory is an aggregate of raw land which, in some cases, may be several years from development, and unregistered projects and their related pre-development costs Pre-development costs include the cost of regulatory approvals, planning, engineering and infrastructure servicing. The latter can be significant in instances where utilities or roadways are constructed over expanses of raw land in order to bring services or access to subdivisions that are being developed. Land inventory increased by $54,172,000 primarily due to land acquisitions of $55,349,000 and due to an increase of $5,017,000 in pre-development costs.

Financing

The Division attempts to finance its land acquisition activities by obtaining vendor financing on a portion of the acquisition price. Please see the "Financial Instruments" section of this MD&A for further information.

The Division may also access a credit facility which, on a margined basis, allows for the borrowing of money using agreements receivable and developed land inventory as collateral. Please see the "Liquidity" section of this MD&A for further information.

Risk Factors

Residential lot sales are influenced by the demand for new housing which is impacted by interest rates, growth in employment, immigration, new family units and the size of these units. Our ability to bring new communities to the market is impacted by municipal regulatory requirements and environmental considerations which affect the planning, subdivision and use of land. The lengthy planning and approval process can take up to eighteen months. During this period, the market conditions in general and/or the market for lots in the size and price range in our developments may change.

The timing of revenue recognition is dependant upon the occurrence of plan registrations. Plan registrations are the result of an exacting process. Various interested parties and approval agencies are involved. While associated requirements are generally predictable in terms of certainty of resolution, they are less predictable in terms of timing.

The Company must manage its assets to ensure that it has adequate financial and operational cash flow to support the holding cost of its inventory and land holdings.

Management attempts to mitigate these risks by:

- Developing in the vicinity of major population and employment centres in Alberta where we have developed land for decades;
- Making the strategic acquisition of land for future development a priority;

- Marketing lots in various sizes and price ranges in all regions in which we carry on development programs;
- Monitoring market conditions by maintaining close contact with our customers, industry associations and forecasting agencies;
- Managing and participating in joint ventures;
- Contracting highly regarded professional consultants as required rather than having them on staff; and
- Practicing an environmental program to minimize risk on acquisitions and development.

Property Development Operations

The Property Development Division acquires commercial sites from the Community Development Division at fair market value with the goal of creating additional value by developing the sites into revenue producing properties. Once completed, these assets are transferred at fair market value to the Investment Property Division, with a mandate to hold and manage them. The profit earned on transfer, is eliminated upon consolidation.

Strategic initiatives for 2007 – 2009 include:

- To implement the Business Plan for the Division and to meet the Corporate objectives of asset diversification, income growth and stability by constructing revenue producing developments primarily on land created through land development activities in Alberta.
- To commence construction and leasing on up to 27,000 square feet of retail space in Leduc Common;
- To continue the development of Chestermere Station in Chestermere, Alberta;
- To finalize the construction and leasing of the Crowfoot West Business Centre in N.W. Calgary;
- To further the development of the Market at Magrath by initiating construction of a multi-floor office/retail building; and
- To advance projects in Spruce Grove, Red Deer, Airdrie, Calgary and Lethbridge on lands currently transferable from the Community Development Division.

Operating Review

($000s)	**2006**	2005	2004	2003	2002
Revenue	**13,638**	9,392	4,058	2,692	13,650
Cost of sales	**(11,531)**	(6,950)	(3,582)	(2,296)	(11,533)
Net operating income (NOI) [1]	**2,107**	2,442	476	396	2,117
Administrative expenses	**(518)**	(349)	(263)	(235)	(257)
Divisional earnings	**1,589**	2,093	213	161	1,860

1 See "Non-GAAP Financial Measures" section

Sales Activity

Most of the sales activities for the Division are generated from the transfer of revenue producing assets to the Investment Property Division. The Division may also earn management fees when managing the development of properties within a joint venture or from the sale of a commercial site to an outside party.

During the year, three pad sites within the Market at Magrath development were completed and transferred to the Investment Property Division. In addition, the Division sold 3.8 acres of land within the Market at Magrath to a major grocery retailer.

In Westgrove Common, the Division completed a 5,500 square foot retail building during the year and transferred it to the Investment Property Division. This building is 100% leased and will commence earning rental revenues in the first quarter of 2007.

In addition, the Division completed four buildings totalling approximately 30,000 square feet (including joint venture interest at 100%) in Chestermere Station, a 100,000 square foot grocery store-anchored regional shopping centre. These assets are 100% leased and were thus transferred to the Investment Property Division during the first quarter of 2006.

Development Activity

During the year, the Division commenced the construction of the Crowfoot West Business Centre, a four storey, 115,000 square foot office/retail project which is within a half block of the Company's existing Crowfoot Business Centre. The construction of this building is on schedule and is expected to be completed in mid 2007. Preleasing activities have commenced and there has been significant interest from prospective tenants.

In addition, the Division expects to commence construction on a 67,500 square foot office/retail building at the Market at Magrath during the 2007 year. This project will consist of three storeys of retail and office space.

In Chestermere Station, the Division is currently constructing two buildings totalling approximately 25,000 square feet (including joint venture interest ay 100%) which should be completed during the first quarter of 2007.

Construction of a pad site in Phase I of Leduc Common commenced in the fourth quarter of 2006 and is expected to be completed in the first quarter of 2007. Construction of a 27,000 square foot retail building in Phase III of the development is scheduled to commence in 2007.

The Division has potential projects that will receive significant planning activity in 2007, namely:

- Airdrie Commercial Lands;
- Red Deer;
- Lewis Estates; and
- Lethbridge.

Financing

The Division funds its operations through interim financing from financial institutions or from internal sources. Historically, the Division has been successful in obtaining very competitive long-term fixed rate financing terms by waiting until the asset has been built and substantially leased. Typically, the Company obtains financing on behalf of the Investment Property Division which attempts to achieve a 75% loan to value ratio based on the appraisal value of the assets. During the 2006 year, the Division entered into an interim financing arrangement to fund the construction of the Crowfoot West Business Centre. This project loan with a major chartered bank allows for monthly funding draws as construction costs are incurred. As at December 31, 2006, there was $9,394,000 of debt in the Division.

Risk Factors

The major risks include:

- Leasing risks (finding qualified tenants to lease the completed space);
- Construction risks (managing the cost and quality of developing the project); and
- Financing risks (ensuring the project has adequate financing resources).

Management attempts to mitigate these risks by:

- developing in the vicinity of major population and employment centres where the Company conducts business and owns similar assets;
- hiring professional consulting firms to aid in the planning and design of the project;
- using professional consultants and realtors to market the new projects;
- analysing market conditions and evaluating potential customers;
- obtaining adequate pre-leasing levels prior to construction;
- acquiring the land after the project is approved (i.e. sites are not inventoried);
- contracting with reputable construction companies that use fixed/target price contracts;
- constantly monitoring leasing activity, construction progress and project costs; and
- communicating with financial institutions regarding interim and take-out financing.

Investment Property Operations

The Investment Property Division has established itself as a key contributor to the continuing success of Melcor as one of Alberta's premier real estate development companies. The majority of the Division's assets are managed by the Company.

Strategic initiatives for 2007 – 2009 include:

- To implement the Business Plan for the Division to meet objectives of increasing the return on investment;
- To acquire new investment properties (i.e. Class "B" office buildings in Western Canada) where significant increased value can be created within a 5-year timeframe;
- To seek out un-tapped revenue opportunities in existing assets;
- To enhance the quality of the portfolio's assets by upgrading their appearance, functionality and desirability thereby increasing their rental outputs;
- To focus on client retention through continual customer contact and ongoing service evaluation;
- To obtain and maintain financing to ensure reasonable leverage of its assets;
- To update and execute detailed leasing strategies for each asset; and
- To increase occupancy levels by 3% over the next 3 years.

Operating Review

($000s)	2006	2005	2004	2003	2002
Rental revenue	**19,765**	15,749	12,088	10,235	7,651
Operating expenses	**(9,260)**	(7,607)	(6,144)	(5,676)	(3,981)
Net operating income (NOI) [1]	**10,505**	8,142	5,944	4,559	3,670
Interest income	**36**	22	11	17	-
Interest expense	**(3,811)**	(2,914)	(2,234)	(2,083)	(1,219)
Depreciation	**(1,848)**	(1,375)	(1,148)	(715)	(549)
Amortization of tenant leasing costs	**(1,456)**	(1,145)	(884)	(713)	(721)
Administrative expenses	**(535)**	(451)	(322)	(338)	(201)
Earnings from operations	**2,891**	2,279	1,367	727	980
Gain (loss) on sale of assets	**11,108**	-	-	1,559	991
Divisional earnings	**13,999**	2,279	1,367	2,286	1,971

1 See "Non-GAAP Financial Measures" section

The Investment Property Division experienced significant growth in 2006 in revenues, net operating income and earnings from operations. Overall, occupancy went up from 92% to 93%. This was in line with the Division's 2005 goal of increasing occupancy by 4% over 3 years. While this increased occupancy and growth in operational performance is partly a result of acquisitions, the majority of the growth is a result of better performance from the existing portfolio.

Selected Financial Benchmarks

($000s)	2006	2005	2004	2003	2002
Asset book value	**93,726**	80,186	56,408	50,820	43,853
Financing	**(85,079)**	(64,314)	(34,354)	(35,573)	(29,280)
Net investment	**8,647**	15,872	22,054	15,247	14,573
EBITDA [1]	**8,514**	6,546	4,738	3,508	2,748
NOI as % of rental revenue [2]	**53.1%**	51.7%	49.2%	44.5%	48.0%
Earnings from operations as % of net investment [2]	**23.6%**	12.0%	7.3%	4.9%	5.5%
Divisional earnings as % of net investment [2]	**114.2%**	12.0%	7.3%	15.3%	11.0%
EBITDA as % of asset cost [2]	**9.7%**	9.5%	8.8%	7.4%	6.7%
% assets financed [2]	**90.8%**	80.2%	60.9%	70.0%	66.8%

1 See "Non-GAAP Financial Measures" section

2 See "Calculations" in "Non-GAAP Financial Measures" section

Asset book value comprises commercial properties, manufactured home property, tenant leasing costs and major repairs which are recoverable from tenants. In 2006, the Division financed three properties for proceeds of $18,850,000. The Company used two lenders and achieved terms ranging from 5 to 10 years with a weighted average interest rate of 5.2%.

Property Holdings

	Year Acquired	Rentable Square Feet Office	Retail	Total	% Leased 2006	2005
BUILDINGS						
Edmonton, Alberta						
Melton Building	1973	100,803	12,130	112,933	88	90
Corinthia Plaza	1975	-	23,143	23,143	100	93
Westcor Building	1978	59,024	12,811	71,835	100	98
Princeton Place	1999	50,110	8,448	58,558	100	81
Capilano Centre (*)	1999	69,008	29,550	98,558	92	93
100 Street Place	2000	41,221	3,074	44,295	96	84
Birks Building	2001	24,801	9,884	34,685	69	67
Westgate Business Centre	2001	74,649	-	74,649	100	100
Glentel Building	2002	15,968	-	15,968	100	100
Associated Centre	2002	54,272	19,205	73,477	93	91
Leduc Common	2003/2004/2005	-	82,390	82,390	100	97
Sterling Business Centre	2003	67,909	-	67,909	100	100
Kingsway Business Centre	2004	33,432	-	33,432	100	100
Royal Bank Building	2005	118,493	17,191	135,684	82	83
Westgrove Common	2006	-	5,512	5,512	100	-
Market at Magrath	2006	-	13,778	13,778	100	-
Calgary, Alberta						
Kensington Road Building	1980	17,867	5,984	23,851	100	91
Crowfoot Centre	2002	44,924	23,699	68,623	99	99
Chestermere Station (*)	2006	-	29,562	29,562	100	-
Regina, Saskatchewan						
Albert Street Building	1979	6,150	-	6,150	34	66
University Park Plaza	1981	-	41,206	41,206	93	94
Kelowna, British Columbia						
Kelowna Business Centre	2006	35,653	36,429	72,082	88	-
		814,284	373,996	1,188,280	93	92

Location/Name	Year Acquired	Units	Site Size (Square Feet)	% Leased 2006	2005
OTHER REVENUE ASSETS					
Edmonton, Alberta					
104 Street Parking Lot #1	2001	28	n/a	100	100
104 Street Parking Lot #2	2002	28	n/a	100	100
Royal Bank Parkade	2005	330	n/a	100	100
Leduc Common (land leases)	2003/2004/2005	n/a	336,000	100	100
Edward Street Apartments	2006	11	n/a	100	-
Calgary, Alberta					
Crowfoot Circle (land lease)	1999	n/a	43,560	100	100
MANUFACTURED HOME COMMUNITY					
Calgary, Alberta					
Watergrove (*)	1995	308	n/a	100	100

(* Joint Venture)

Property Transactions

The Division had the following additions and disposals in 2006:

- During the first quarter, the Division acquired four buildings totalling approximately 30,000 square feet of retail space (including joint venture interest at 100%) in Chestermere Station from the Property Development Division.
- During the third quarter, the Division acquired the Kelowna Business Centre in downtown Kelowna for $9,178,000;
- On September 22, 2006 the Division announced the sale of a 40,000 square foot site in downtown Calgary. The disposal of this site generated a material gain of approximately $0.29 per share;
- During the fourth quarter, the Division acquired three pad sites within the Market at Magrath from the Property Development Division. Rents for these sites will begin in the first quarter of 2007; and
- During the fourth quarter, the Division acquired one building totalling approximately 5,500 square feet in Westgrove Common from the Property Development Division. Rents for these sites will begin in the first quarter of 2007.

Financing

The Division normally finances its assets with fixed rate long-term mortgage financing. The advantages of this strategy include:

- Reduction of interest rate risk as mortgages are financed over fixed terms of five to fifteen years;
- Returns are increased due to leverage; and
- Cash flow from financing helps to fund asset acquisitions thus allowing the Division to expand its asset base without using cash from other Divisions.

Those assets where performance is below optimum levels needed to obtain market rates or desired leverage, are either left unencumbered or financed with short term, floating rates until such time as performance improves and satisfactory financing is attainable.

See the "Financial Instruments" section of this MD&A for further information.

Risk Factors

The two major risks affecting the Division are retaining existing tenants and attracting new tenants. The Division is subject to the market conditions in the geographic areas where it owns properties. As these market conditions change, the ability to achieve higher occupancy rates also changes. Market conditions are influenced by outside factors such as government policies, demographics and employment patterns, the affordability of rental properties, competitive leasing rates and long-term interest and inflation rates.

Management attempts to mitigate these risks by:

- owning properties in the vicinity of major population and employment centres, (normally in areas where we also develop land for resale);
- diversifying the type of investment properties in the portfolio;
- managing and participating in joint ventures;
- purchasing properties that are below replacement value, which improves prospects for future appreciation in lease rates and property values;
- obtaining long-term, fixed-rate financing when the features of the specific property meet conditions that generate competitive financing terms;
- managing our buildings so as to have competitive operating costs; and
- maintaining adequate insurance coverage to protect the Division's income stream, assets and exposure to third party claims.

Recreational Property Operations

This Division owns and manages two 18-hole championship golf courses being The Links at Spruce Grove and Lewis Estates Golf Course (60% joint venture) and owns a golf course under construction in Kelowna, British Columbia in the Black Mountain region.

Strategic initiatives for 2007 – 2009 include:

- To enhance Divisional performance through revenue growth and potential acquisitions of golf course properties; and
- To complete construction of the Black Mountain golf course.

Operating Review

($000s)	2006	2005	2004	2003	2002
Revenue	**3,026**	3,228	2,756	2,951	2,908
Operating costs	**(1,708)**	(1,466)	(1,434)	(1,416)	(1,414)
Net operating income (NOI) [1]	**1,318**	1,762	1,322	1,535	1,494
Interest expense	**(280)**	(178)	(88)	(108)	(52)
Administrative expenses	**(630)**	(631)	(525)	(553)	(529)
Depreciation expense	**(333)**	(244)	(241)	(267)	(249)
Gain/(Loss) on sale of capital assets	**14**	(63)	-	19	12
Divisional earnings	**89**	646	468	626	676

1 See "Non-GAAP Financial Measures" section

Selected Financial Benchmarks

($000s)	2006	2005	2004	2003	2002
Asset cost	**11,861**	9,231	5,892	5,647	5,432
Accumulated depreciation	**(3,336)**	(3,168)	(3,047)	(2,806)	(2,644)
	8,525	6,063	2,845	2,841	2,788
Less debt related to golf courses	**(4,790)**	(5,117)	(1,602)	(1,762)	(1,890)
Net investment	**3,735**	946	1,243	1,079	898
EBITDA [1]	**688**	1,131	797	982	965
NOI as % of revenue [2]	**43.6%**	54.6%	48.0%	52.0%	51.4%
Divisional earnings as % of net investment [2]	**3.8%**	59.0%	40.3%	63.3%	48.9%
EBITDA as % of asset cost [2]	**6.5%**	15.0%	13.8%	17.7%	17.9%
% assets financed [2]	**56.2%**	84.4%	56.3%	62.0%	67.8%

1 See "Non-GAAP Financial Measures" section

2 See "Calculations" in "Non-GAAP Financial Measures" section

Revenue and earnings in 2006 were down due to intense competition in the recreation/entertainment market in the Edmonton area and weather conditions that resulted in an early end of the golf season. In addition, ongoing construction of the Lewis Estates clubhouse, completed during the third quarter of 2006, negatively impacted revenues for that golf course. The division also has incurred expenses from the Black Mountain Golf Course which does not generate revenue at this time.

Construction on the remaining 9 holes of the golf course in Kelowna has begun and is scheduled to be completed in the fall of 2007 with the course opening in 2008.

Weather permitting, the Company expects to show moderate growth to revenue and earnings for 2007.

Operational Activity

The courses are maintained consistent with the adopted objectives of a recognized championship public golf course. This sustains a positive economic balance between the level of the course fees, the number of rounds attracted and the level of enjoyment experienced by our customers as it relates to course conditions. Both courses have a reputation of consistently being in excellent condition overall.

Equipment/Assets

The Division purchases and maintains recognized brand name grounds-keeping equipment, which allow grounds crews to perform a superior job. Golf carts are replaced every 6 to 8 years.

In 2006, the Company completed construction of a club house at Lewis Estates replacing the temporary club house which had served the golf course for 10 years. The new club house was completed at a cost of $2,630,000 (including joint venture interest at 100%).

In 2006, the Company continued development on a golf course/residential community in Kelowna, British Columbia. To date, the Company has invested $4,100,000 in land and construction costs.

Financing

The Division's financing goals are similar to those of the Investment Property Division (i.e. to obtain long-term fixed rate financing). Currently, the Lewis Estates Golf Course is financed with a variable rate mortgage and is part of a comprehensive financing arrangement which also includes a term loan respecting future development lands. The Links at Spruce Grove was financed in 2005 generating mortgage proceeds of $3,750,000.

The Division has entered into an agreement to increase the current variable rate mortgage on the Lewis Estates Golf Course. It is expected that the existing mortgage will increase to $3,200,000 (from $2,140,000 at December 31, 2006) during the first quarter of 2007.

Risk Factors

The primary risk factor is to continue to attract golfers to play at the Division's golf courses. Golf course results are subject to weather, number of playing days, competition from other courses, the amount of disposable income available to customers to spend on recreational activity, popularity of the sport and the cost of providing desirable playing conditions.

Management attempts to mitigate these risks by:

- owning golf courses near high population areas;
- keeping green fees competitive, but sufficient to maintain a high standard of course conditions;
- servicing the corporate golf tournament business, which increases the number of sold out days and provides revenue on marginal weather days;
- building good practice facilities at the courses and by providing excellent professional golf instruction; and
- practicing efficient, courteous and professional customer relations to encourage patrons to return.

Liquidity

Management believes that with the projected level of operations for 2007, our capital commitments and the availability of funds under the established credit facility, the Company will have sufficient capital to fund its operations and continue investing in land inventory and revenue producing assets.

The Company is relatively conservative as it relates to its use of debt to finance its operations. This is evidenced by the debt to equity ratio (total debt divided by total equity as per the balance sheet) over the past 5 years which is as follows:

2006	2005	2004	2003	2002
1.22 to 1	1.13 to 1	.84 to 1	.79 to 1	.83 to 1

The Company has an ongoing requirement to finance its operations. The Company has a credit facility with a major chartered bank. Under the terms of this facility, the Company pledges specific agreements receivable, specific lot inventory and a general security agreement as collateral. This credit facility may be terminated by the bank upon one year's notice and may be modified to meet the Company's needs. A summary of the credit facility is as follows:

($000s)	**2006**	2005	2004	2003
Supportable credit limit	**88,900**	76,700	43,500	51,000
Credit limit approved	**61,800**	43,250	29,650	31,000
Credit used	**29,599**	16,026	10,167	1,642

In addition to the credit facility above, the Company can raise equity, capital and debt financing as discussed in the "Capital Resources" section of this MD&A.

Cash Flows

The Company received cash of $18,031,000 from operating activities which is a decrease of $3,611,000 over the amount received in 2005. The primary use of funds was an increase of $41,843,000 in agreements receivable and $4,361,000 in other assets and liabilities. Earnings of $57,771,000, non-cash items which were expensed in earnings of $9,383,000 and increased funds from the net change of development activities of $8,203,000 were the main source of funds from operating activities. Cash from operating activities was decreased by $11,118,000 due to the net inclusion of non-cash gains on sale of investment properties and capital assets.

The Company used $33,055,000 in cash for investing activities which is a decrease of $13,400,000 over the amount used in 2005. The primary use of cash was the purchase/development of investment properties of $24,279,000 (a decrease of $5,384,000 over 2005 purchases) and the purchase of land inventory of $25,477,000 (an increase of $8,738,000 over 2005 purchases). These purchases were partially offset by proceeds from the sales of investment properties of $16,775,000 (2005 – $51,000).

The Company received $17,567,000 from financing activities which is a decrease of $10,116,000 over 2005 when the Company received $27,683,000 in financing activities. The primary source of funds was mortgage financing of $44,577,000 (2005 – $47,358,000). The Company also raised $766,000 from the issuance of share capital resulting from the exercising of employee share options. The Company made debt repayments of $32,050,000 which is an increase of $15,300,000 over the debt repayments made in 2005 and paid $9,299,000 in dividends (2005 – $7,660,000) which is an increase of $1,639,000 over the amount paid in 2005.

Contractual obligations include:

($000s)	Total	Payments Due by Period Less than 1 Year	1 - 3 Years	4 - 5 Years	After 5 Years
Long term debt	**162,309**	18,187	39,209	16,945	87,968
Operating leases	**16**	16	-	-	-
Purchase obligations	-	-	-	-	-
Total contractual obligations	**162,325**	18,203	39,209	16,945	87,968

Capital Resources

Equity

The Company has issued stock options to its employees. As these options become vested, they can be exercised by the employee, thus raising share capital for the Company. If all outstanding options are exercised at their earliest date, the Company stands to raise $4,760,000 in share capital by 2011. See the "Outstanding Share Data" section in this MD&A for further information.

The Company has an outstanding normal course issuer bid which allows the Company to purchase up to 1,550,000 common shares during a one year period ending on September 17, 2007. In 2006, the Company did not purchase any common shares under the bid. In 2005, the Company purchased 620,000 common shares for $3,286,000. If the Company purchases shares under the current bid, capital resources will be used depending on the price and quantity of shares purchased.

Debt

The Company could raise additional financing from the following sources:

- Credit facility (see the "Liquidity" section of this MD&A for further information);
- Refinance existing investment property assets for greater mortgage proceeds (see the "Financial Instruments" section of this MD&A for further information);
- Place interim or take-out financing for properties under development within the Property Development Division; and
- Place new financing on unencumbered assets.

Off Balance Sheet Arrangements

Letters Of Credit

The Company has an ongoing requirement to provide letters of credit to municipalities as part of the subdivision plan registration process. These securities would provide a source of funds to the municipalities that would allow them to complete the construction of the subdivision should the Company not be able to. The amount of any particular letter of credit is reduced at various stages of construction. Once the municipality issues a certificate acknowledging completion of the project, the letter of credit is cancelled.

The Company records the estimated cost of completion, for all single family lots and parcels (i.e. multi family, commercial and industrial sites) sold as a liability in "Provision for land development costs" in the balance sheet. The amount of individual letters of credit will normally exceed the related liability recorded in the accounts due to the timing of the ongoing expenditures which are incurred as the project is being developed compared to the timing of reductions in the balance of the corresponding letter of credit.

The Company's letter of credit facility is part of the Company's overall credit facility that was negotiated with a major Canadian chartered bank. The Company's letter of credit balances over the past three years, net of joint venture interests are:

($000s)	2006	2005	2004
Total facility	**37,300**	29,031	25,256
Amount outstanding	**(30,516)**	(22,939)	(15,886)
Available for issue	**6,784**	6,092	9,370

Joint Venture Guarantees

The Company has a history of conducting a significant portion of its business through joint ventures as a way of diversifying development and investment risk. Currently, Melcor is a participant and manager of 16 joint ventures. As manager, the Company has arranged appropriate credit facilities for all active joint ventures which margin pre-development work, agreements receivable and lot inventory to provide a line of credit facility to accommodate development activities. In some cases, the Company's guarantee for these facilities goes beyond the Company's proportionate share of the liability. The following table illustrates guarantees made by the Company related to joint venture agreements.

($000s)	2006	2005	2004
Net loan guarantees	**6,169**	11,264	10,563
Letter of credit guarantees	**6,350**	5,300	3,580
Amounts secured by joint venture agreements	**12,519**	16,564	14,143

To mitigate the possibility of financial loss, Melcor is diligent in its selection of joint venture participants. As well, Melcor has remedies available within the Joint Venture Agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint venture participants.

Joint Venture Activity

The Company uses the proportionate consolidation method to account for its joint ventures. The following table illustrates selected financial data related to joint ventures at 100% as well as the net portion relevant to Melcor.

Joint Venture Activity at 100%

($000s)	2006	2005	2004	2003	2002
Revenue	**104,665**	78,863	63,857	45,068	47,852
Earnings	**31,945**	24,640	21,588	16,171	14,149
Assets	**225,677**	202,569	161,254	109,310	94,677
Liabilities	**110,881**	108,508	84,659	49,724	48,977

Melcor's Portion (30.0% - 75.0%)

($000s)	2006	2005	2004	2003	2002
Revenue	**55,572**	45,666	34,117	26,782	25,947
Earnings	**17,157**	14,266	11,133	8,947	7,325
Assets	**120,963**	108,036	85,600	57,862	50,034
Liabilities	**56,045**	57,849	44,968	26,130	28,785

The activities of the sixteen joint ventures are as follows:

- (1) Commercial Property;
- (1) Manufactured Home Community;
- (1) Active land development and golf course operations;
- (1) Active land development with commercial property development activities;
- (6) Active land development activities; and
- (6) Non-active land development with activities expected to commence in 2-4 years.

Critical Accounting Estimates

The Company's most significant estimates relate to measuring cost of sales in the Community Development Division which sells parcels of land prior to all costs being committed or known. These estimates are necessary to facilitate the reporting of earnings. The nature of the land development industry includes lengthy time frames to complete all municipal requirements.

When the Community Development Division obtains plan registration for a new phase of a subdivision, the estimated total cost to build the phase is determined and once a lot sale is recorded, the estimated unexpended portion of that cost is set up as a liability in the "Provision for land development costs".

The Division uses independent consultants to help in the preparation of construction budgets, which tend to be conservative in nature. When actual development costs related to the subdivision are incurred, they are applied against the provision.

At least once per year, actual costs are reviewed against the budget and revisions are made when the estimated unexpended portion of the provision is known to be materially different from the revised estimate to complete the project.

The most significant factors causing revisions to estimates are as follows:

- Increases/decreases to contract amounts from when they are estimated to when they are actually awarded;
- Changes in costs that are contracted by the unit and the number of units vary from the estimate (i.e. volume of earth required to be moved); and
- Other changes typical in a construction environment where future events and uncertainty cannot be reasonably predicted, such as contingencies and allowances for those items which can only be estimated within a range of values and are known only after project completion.

The market conditions of the past four years have been somewhat more volatile than they had been in years prior. Suppliers of development inputs are working at capacity. This has increased the risk of making estimation errors.

Changes In Accounting Policies Including Initial Adoption

The Accounting Standard Board of the Institute of Chartered Accountants of Canada issued Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges" and Section 1530, "Comprehensive Income" for annual and interim periods for fiscal years beginning on or after October 1, 2006.

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and the measurement of such amount. It also specifies how financial instrument gains and losses are to be presented. Section 3865 is applicable for designated hedging relationships and builds on existing Canadian GAAP guidance by specifying how hedge accounting is applied and what disclosures are necessary when it is applied. Section 1530 introduces new standards for the presentation and disclosure of components of comprehensive income. Comprehensive income is defined as the change in net assets of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in net assets during a period except those resulting from investments by owners and distributions to owners.

The Company is not expecting a material effect on our financial position or the results of our operations due to the initial adoption of these recommendations in fiscal 2007.

During the year, the Company applied the interpretations of the Canadian Institute of Chartered Accountants Emerging Issues Committee Abstract 159 "Conditional Asset Retirement Obligations" (EIC-159). Under EIC-159, a liability should be recognized if the entity has sufficient information to reasonably estimate the fair value of the asset retirement obligation. The Company has determined that it has a conditional asset retirement obligation relating to the removal of asbestos in one of its commercial properties. The Company believes that there is insufficient information to estimate the fair value of the asset retirement obligation because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique. For example, there are no plans to undertake a major renovation that would require removal of the asbestos or demolition of the property. The property is expected to be maintained by repairs and maintenance activities that would not involve the removal of the asbestos. Also, the need for major renovations caused by operational changes or other factors has not been identified.

Disclosure Controls & Procedures And Internal Controls Over Financial Reporting

Melcor's management, including the President and Chief Executive Officer and the Vice-President Finance, has reviewed and evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators) as of December 31, 2006.

Management has concluded that, as of December 31, 2006, the disclosure controls and procedures were effective to provide reasonable assurance that material information relating to the Corporation and its consolidated subsidiaries and joint ventures would be made known to them by others within those entities, particularly during the period in which this report was being prepared. Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Due to the size of the Company, instances of insufficient segregation of duties, lack of independent review and inadequate documentation of procedures performed have been noted. These weaknesses have been partially mitigated by numerous compensating controls and a strong control environment. Remediation of these identified weaknesses, where practical, will be undertaken throughout the year.

There have been no changes in the Corporation's internal controls over financial reporting during the year that have materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over material reporting.

Notwithstanding the foregoing, no assurance can be made that the Company's controls over disclosure and financial reporting and related procedures will detect or prevent all failures of people within the Company to disclose material information otherwise required to be set forth in the Company's reports.

Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable, agreements receivable, bank operating loan, income taxes payable, accounts payable and accrued liabilities, debt on land inventory and debt on investment properties. The Company believes that the fair value of financial instruments approximates their carrying values. The fair value of cash and cash equivalents, accounts receivable, bank operating loan, income taxes payable, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature.

The fair value of agreements receivable are estimated based on the interest bearing nature of these instruments which are at rates consistent with market rates for debt instruments with similar terms to maturity. The fair value of debt on land inventory and debt on investment properties are estimated based on quoted market rates for similar instruments with similar terms.

Agreements receivable are a financing tool used by the Company to assist builders to acquire lots. Normal terms include repayment within one year, interest at prime plus two percent after any provision for an interest relief period and an above market interest rate for balances that are past due.

The Company retains full security until the agreement receivable has been collected. The Company seldom incurs bad debt losses in relation to agreements receivable.

Debt on land inventory is normally comprised of loans from the acquisition of land that are primarily held by the land vendor (fixed rate financing with repayments over 3 to 10 years) or from financial institutions (variable rate financing with repayments over 3 to 5 years). In addition, the Company may obtain financing from a financial institution in order to commence major infrastructure in a new community or obtain project financing when the borrowing requirement falls outside the normal parameters that are currently met with a line of credit. This type of loan usually has floating rates of interest tied to prime. The following carry forward table illustrates the changes in debt on land inventory over the past five years:

Debt on Land Inventory

($000s)	**2006**	2005	2004	2003	[illegible]
Balance at beginning of the year	**50,478**	40,311	35,885	29,141	12,776
New loans	**46,205**	24,575	12,396	13,596	22,644
Repayments	**(24,243)**	(14,408)	(7,970)	(6,852)	(6,279)
Balance at end of the year	**72,440**	50,478	40,311	35,885	29,141
Weighted average interest rate	**5.5%**	4.9%	4.8%	5.1%	5.8%

Debt on investment properties includes loans which are normally fixed rate and long-term in nature. Rates are negotiated at a pre-agreed benchmark bond rate plus a spread and are negotiated with different lenders to ensure competitive terms and multiple sources. Loan maturity dates are spread out so as to reduce associated loan renewal risks. The following table represents cumulative loan amounts due for renewal over the next thirteen years for fixed rate mortgages (including the golf courses):

Year	Loan Renewal Amount ($)	Weighted Average Current Interest Rates	Number of Loans
2007	2,885,000	6.9%	2
2008	6,605,000	5.7%	4
2009	395,000	6.4%	1
2010	15,947,000	5.1%	5
2011	5,988,000	5.2%	1
2012	10,423,000	7.0%	3
2015	7,928,000	5.4%	2
2016	4,588,000	5.6%	1
2020	8,489,000	5.3%	2

Debt on investment properties in the amount of $89,869,000 reflects financing placed on investment properties that have a net book value of $94,069,000. The following carry forward table illustrates the changes in debt on investment properties over the past five years:

Debt On Investment Properties

($000s)	**2006**	2005	2004	2003	2002
Balance at beginning of the year	**69,432**	35,956	37,335	31,170	16,599
New mortgage financing (net)	**28,244**	35,818	-	9,100	15,870
Loans assumed	-	-	-	1,917	1,971
Repayments	**(7,807)**	(2,342)	(1,379)	(4,852)	(3,270)
Balance at end of the year	**89,869**	69,432	35,956	37,335	31,170

Outstanding Share Data

The Company has only one class of Common Shares authorized. Their issuance is as follows:

Outstanding Shares (#)	2006	2005	2004	2003	2002
Outstanding shares at beginning of year	**30,755,620**	30,545,030	30,828,030	30,521,130	30,457,230
Stock Options exercised	**300,100**	830,590	337,000	306,900	131,900
Shares purchased and cancelled	-	(620,000)	(620,000)	-	(68,000)
Outstanding shares at end of year	**31,055,720**	30,755,620	30,545,030	30,828,030	30,521,130

Outstanding Stock Options (#)	2006	2005	2004	2003	2002
Outstanding options at beginning of year	**1,216,610**	1,821,600	2,157,000	2,396,900	1,623,800
Stock Options granted	**53,600**	232,000	12,000	93,000	971,000
Stock Options exercised	**(300,100)**	(830,590)	(337,000)	(306,900)	(131,900)
Stock Options forfeited	**(8,000)**	(6,400)	(10,400)	(26,000)	(66,000)
Outstanding options at end of year	**962,110**	1,216,610	1,821,600	2,157,000	2,396,900

In the future, the maximum stock options which could be exercised based on existing employee stock option programs, are in the table below. This could change if new stock options are granted or if existing options expire or are forfeited. Also, it could change if employees defer the exercise of their stock options to periods subsequent to their vesting period.

Exercisable Stock Options	2007	2008	2009	2010	2011
Maximum options exercisable in the future (#)	762,710	76,093	57,493	55,095	10,720
Maximum increase in share capital ($)	3,012,000	576,000	503,000	491,000	178,000

Fourth Quarter Results

The results from the fourth quarter in 2006 were the best quarterly net earnings in the history of the Company. The increase in earnings was primarily due to increased land sales in the Community Development Division in all regions and a significant gain on disposal realized by the Investment Property Division.

The history of the past (4) fourth quarter results are as follows:

	For the three months ended December 31st			
($000s)	**2006**	2005	2004	2003
Revenue	**85,891**	69,506	35,891	19,592
Cost of sales	**(44,563)**	(42,664)	(19,947)	(8,991)
	41,328	26,842	15,944	10,601
Interest revenue	**1,368**	575	415	533
Interest expense	**(1,710)**	(1,190)	(603)	(640)
General and administrative expenses	**(4,562)**	(2,043)	(1,338)	(1,785)
Amortization expense	**(696)**	(434)	(376)	(234)
Gain/(loss) on sale of capital assets	**11,003**	(63)	-	1
Earnings before income tax expense	**46,731**	23,687	14,042	8,476
Income tax expense	**(13,155)**	(8,301)	(4,333)	(2,431)
Net earnings for the period	**33,576**	15,386	9,709	6,045
Basic earnings per common share	**1.09**	0.51	0.32	0.20
Diluted earnings per common share	**1.06**	0.50	0.31	0.19

Segmented information for the fourth quarter is as follows:

REVENUE ($000s)	For the three months ended December 31, 2006			For the three months ended December 31, 2005		
	Segment Revenue	Inter-segment Eliminations	External Revenue	Segment Revenue	Inter-segment Eliminations	External Revenue
Community development	**81,117**	**(495)**	**80,622**	64,715	44	64,759
Property development	**7,019**	**(6,990)**	**29**	9,291	(9,200)	91
Investment property	**5,232**	**(151)**	**5,081**	4,580	(139)	4,441
Recreation property	**190**	**(31)**	**159**	269	(54)	215
	93,558	**(7,667)**	**85,891**	78,855	(9,349)	69,506
EARNINGS ($000s)	**Segment Earnings**	**Inter-segment Eliminations**	**External Earnings**	Segment Earnings	Inter-segment Eliminations	External Earnings
Community development	**38,417**	**(129)**	**38,288**	24,515	(36)	24,479
Property development	**1,126**	**(1,115)**	**11**	2,276	(2,250)	26
Investment property	**11,740**	**-**	**11,740**	435	-	435
Recreation property	**(365)**	**-**	**(365)**	(270)	-	(270)
	50,918	**(1,244)**	**49,674**	26,956	(2,286)	24,670
NON-ALLOCATED ITEMS:						
Interest income			**33**			105
Interest expense			**(286)**			(14)
General and administrative expenses			**(2,690)**			(1,074)
Earnings before income tax expense			**46,731**			23,687
Income tax expense			**(13,155)**			(8,301)
Net earnings for the period			**33,576**			15,386

Non-GAAP Financial Measures

Melcor uses several non-GAAP measures in evaluating and measuring certain performance results. These non-GAAP financial measures do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers.

Non-GAAP measures include:

- Net Operating Income (NOI) – this measures revenue less direct operating expenses.
- Earnings before interest, taxes (income), depreciation and amortization (EBITDA) – this measure is often used in the real estate industry because it isolates earnings before income taxes (at Melcor's Divisional level, income taxes are not applicable), interest expense, depreciation and amortization to measure operating performance. Interest expense can distort the comparable performance of a property as it depends on the amount of financing carried by the property and the interest rate charged on the loan. Depreciation expense can vary depending on depreciation policies, age of the property and depreciable value of the property. Melcor includes amortization of tenant leasing costs as an expense in arriving at EBITDA.

Calculations

The Company uses the following calculations in measuring the performance of its Divisions:

a) NOI as % of rental revenue = net operating income/revenue

b) Earnings from operations as % of net investment = Earnings from operations/average net investment, i.e. [(opening net investment + closing net investment)/2]

c) Divisional earnings as % of net investment = Division earnings/average net investment, i.e. [(opening net investment + closing net investment)/2]

d) EBITDA as % of asset cost = EBITDA/average asset cost, i.e. [(opening asset cost + closing asset cost)/2]

e) % of assets financed = debt/assets

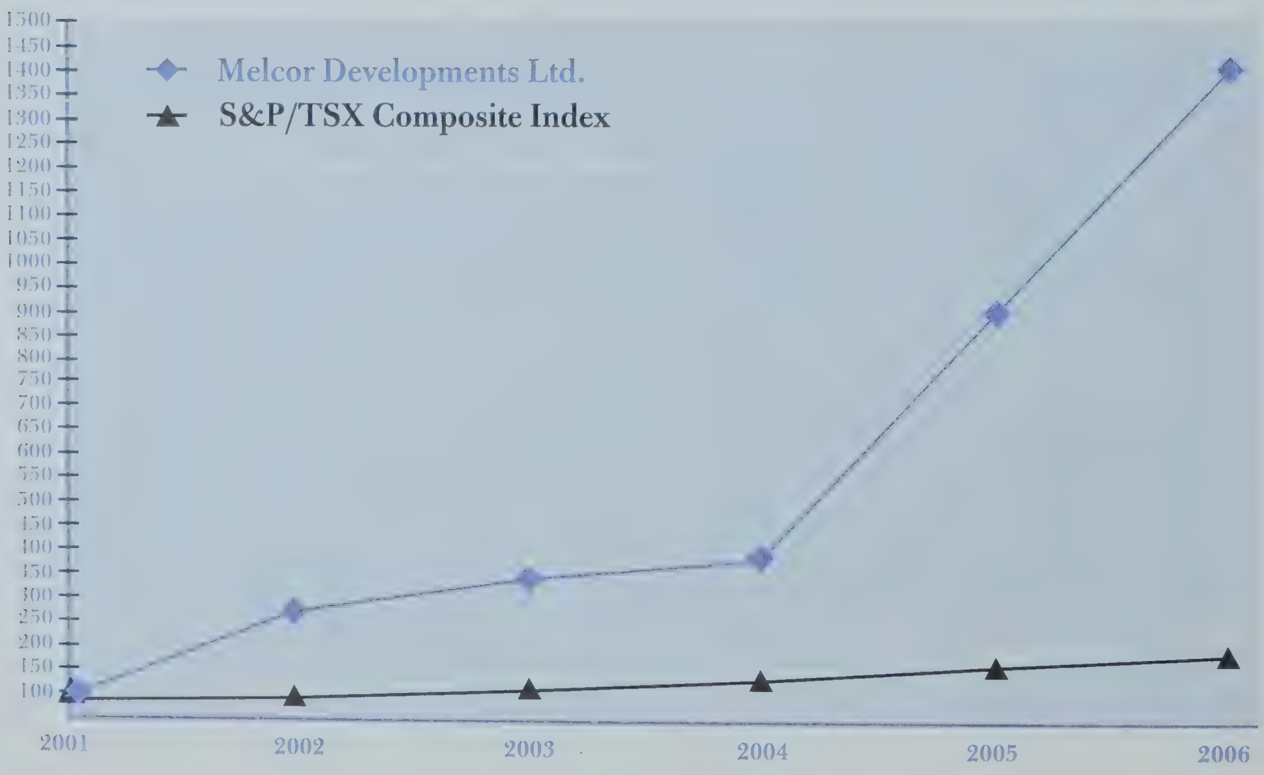
f) Same building calculation = this compares the results of a building owned if it is owned for the entire current and prior years.

Assumptions For 2007 - 2009

- Alberta's economy will continue to experience strong growth leading to high levels of employment and job growth;
- Canada's economy will remain stable with low inflation, low interest rates, a strong dollar (i.e. $.85 – $.90 range in comparison to $1 US) and moderate business and consumer confidence. Mortgage rate increases will be moderate;
- World demand for Alberta commodities will remain strong, especially demand for oil sands products and natural gas;
- Canada's major trading partners will experience stable economies and continue to import Canadian products. U.S. trade will be pressured due to a growing U.S. trade deficit and security concerns in the U.S.;
- The real estate market, especially demand for residential housing will remain strong in Alberta due to relative affordability, job creation, moderate in-migration, confidence and the second generation of the Baby Boom;
- Anti-growth sentiments and financial challenges by municipalities will negatively impact the development industry;
- Increasing real estate inventories and moderating demand will continue to create highly competitive markets while rising input costs will put pressure on margins;
- Melcor will continue to operate in the same business and geographic areas and with the same structure; and
- Energy prices are expected to remain at high levels, but with significant volatility.

Performance Chart - Five Year Cumulative Total Return on $100 Investment (December 31, 2001 - December 31, 2006)

The following chart illustrates Melcor's five-year cumulative total shareholder return, assuming an initial investment of $100 with all dividends reinvested versus the return on the S&P/TSX 300 Composite Index and the TSX Capped Real Estate Index. Over the past 5 years, the investment in Melcor has grown to $1,405 compared to the TSX 300 Composite Index growth of $185 and the TSX Capped Real Estate Index growth of $217.



Corporate Governance Practices

The Board of Directors (the "Board") is responsible for the stewardship of the Company. In executing this role, the Board shall oversee the conduct, direction and results of the business. In turn, management is mandated to conduct the day-to-day business and affairs of the Company and is responsible for implementing the Board's strategies, goals and directions. The Board and its members shall at all times act in the best interests of the Company and its actions shall reflect its responsibility of establishing proper business practices and high ethical standards expected of the Company. The Board has approved a Business Code of Conduct for the Company that is applicable to all Directors, Officers and Employees of the Company. The Board has adopted Corporate Governance Guidelines which, amongst other matters, sets out the Board's principal responsibilities. In discharging the Board's stewardship obligations, the following are specific principal responsibilities of the Board:

- To ensure that the Company adopts a strategic planning process;
- To review and monitor the Company's principal business risks, as identified by management, and the system to manage such risks;
- To appoint, develop and monitor senior management and ensure that management provides for succession planning;
- To ensure that the Company has a policy in place to enable it to communicate effectively with shareholders, other stakeholders and the public generally;
- To ensure there are control and information systems in place for effective discharge of the Board's responsibilities;
- To ensure appropriate corporate governance at all times;
- To know and understand the business of the Company to the best if its ability; and
- To satisfy itself that the Company continually performs with business conduct of the highest quality.

A majority of the board of directors is independent. The Audit Committee and the Governance Committee consist solely of independent directors. As required, the Board will meet in Executive Session at which only the independent directors are in attendance. As the Executive Chairman is not considered to be independent, the Board has appointed a Lead Director with written terms of reference for such position.

Governance Committee

The Board believes in the importance of maintaining sound corporate governance practices, and has therefore established the Governance Committee to periodically review, evaluate and modify governance processes as necessary. This Committee makes recommendations to the Board, in accordance with their approved terms of reference. The Committee is responsible for ensuring that an appropriate corporate governance system is in place for the Board's overall stewardship responsibility and the discharge of its obligations to the stakeholders of the Company. The Committee is also responsible for proposing new nominees to the Board and for assessing the overall performance of the Board and the committees of the Board. With respect to compensation matters, the Committee is responsible for reviewing compensation levels of senior management, evaluating the performance of management and considering management succession and related matters. The Committee receives data on salary levels from the Company and from independent surveys. The executive compensation program is comprised of a base salary, annual incentive compensation and a stock option program.

The Governance Committee is comprised of four independent directors. The current members of the Governance Committee are Lou D. Hyndman (Chairman), William D. Grace, Bruce Saville and Ross A. Grieve.

Audit Committee

The Audit Committee is appointed by, and responsible to the Board. This Committee approves, monitors, evaluates, advises and makes recommendations, in accordance with approved terms of reference, on matters affecting the external and internal audits, risk management matters, the integrity of financial reporting and the accounting control policies and practices of the Company. The involvement of the Committee in overseeing the financial reporting process, including assessing the reasonableness of management's accounting judgments and estimates and reviewing key filings with regulatory agencies, is an important element of the company's internal control over financial reporting. The Committee has oversight responsibility for the performance of both the internal auditors (if any) and the external auditors. The Committee also ensures the qualifications and independence of the external auditors. The Committee has oversight of the Company's compliance with legal and regulatory requirements. It is not the duty of the Committee to plan or conduct audits, or to determine that the Company's financial statements are complete, accurate, and in accordance with generally accepted accounting principles.

The current members of the Audit Committee are William D. Grace (Chairman), Lou D. Hyndman, W. Garry Holmes and Ross A. Grieve. Each member is considered by the Board of Directors to be independent and financially literate within the meaning of Multilateral Instrument 52-110 – Audit Committees.

The Committee assesses the performance and considers the annual appointment of external auditors for recommendation to the Board for ultimate recommendation for appointment by the shareholders, including a review of the auditor's performance, qualifications, independence, audit plans and fees. All non-audit services provided by the external auditors or its affiliates are pre-approved by the Committee which also considers any potential impact the non-audit service may have on the independence of the external audit work. The Committee also receives annual reports from the external auditor on their views of the quality (not just the acceptability) of the Company's annual and interim financial reporting.

The Auditors, Audit Committee and management maintain regular and open communication in relation to the audit of the Company's financial statements. The Auditors review and discuss the Company's unaudited quarterly financial statements and earnings releases with management and the Audit Committee.

Consolidated Statement Of Earnings And Retained Earnings

For the years ended December 31 ($000s)	2006	2005
Revenue	**203,402**	161,500
Cost of sales	**(115,886)**	(86,343)
	87,516	75,157
Interest income	**4,439**	1,887
Interest expense (Note 16)	**(6,427)**	(3,896)
General and administrative expenses	**(11,786)**	(9,442)
Amortization expense	**(2,240)**	(1,682)
Gain/(loss) on sale of investment properties and capital assets	**11,118**	(63)
Earnings before income taxes	**82,620**	61,961
Income tax expense (Note 11)		
Current	**(17,830)**	(13,764)
Future	**(7,019)**	(6,421)
	(24,849)	(20,185)
Net earnings for the year	**57,771**	41,776
Retained earnings, beginning of the year	**177,048**	146,055
Dividends	**(9,299)**	(7,660)
Cost of common shares purchased in excess of stated capital	-	(3,123)
Retained earnings, end of the year	**225,520**	177,048
Basic earnings per share (Note 14)	**1.87**	1.38
Diluted earnings per share (Note 14)	**1.83**	1.35

Consolidated Balance Sheet

As at December 31 ($000s)	2006	2005
Assets		
Cash and cash equivalents	**11,564**	9,021
Accounts receivable	**5,696**	4,570
Agreements receivable (Note 3)	**127,178**	85,335
Land inventory (Note 4)	**255,570**	201,398
Investment properties (Note 5)	**112,430**	86,685
Capital assets (Note 6)	**331**	327
Deferred costs and other assets (Note 7)	**10,158**	8,777
	522,927	396,113
Liabilities		
Bank operating loan (Note 8)	**29,599**	16,026
Accounts payable and accrued liabilities	**26,563**	21,125
Income taxes payable	**3,997**	5,973
Provision for land development costs	**39,805**	29,026
Debt on land inventory (Note 9)	**72,440**	50,478
Debt on investment properties (Note 10)	**89,869**	69,432
Future income taxes (Note 11)	**24,744**	17,725
	287,017	209,785
Shareholders' Equity		
Share capital (Note 12)	**10,789**	10,023
Contributed surplus (Note 12 (f))	**208**	88
Retained earnings	**225,520**	177,048
Currency translation adjustment (Note 13)		
Currency translation adjustment	**(607)**	(831)
	235,910	186,328
	522,927	396,113

Signed on Behalf of the Board

Per: _______________ Director

Per: Ralph Y_______________ Director

Consolidated Statement of Cash Flows

For the years ended December 31 ($000s)	2006	2005
Cash Flows From (Used In) Operating Activities		
Net earnings for the year	**57,771**	41,776
Non cash items:		
Amortization of investment properties	**2,174**	1,614
Amortization of capital assets	**66**	67
Stock-based compensation expense (Note 12 (f))	**120**	78
(Gain)/loss on sale of investment properties	**(11,122)**	63
(Gain)/loss on sale of capital assets	**4**	-
Future income taxes	**7,019**	6,421
	56,032	50,019
Agreements receivable	**(41,843)**	(41,827)
Development activities (Note 21)	**8,203**	(1,968)
Operating assets and liabilities (Note 21)	**(4,361)**	15,418
	18,031	21,642
Cash Flows From (Used In) Investing Activities		
Purchase of land inventory (Note 4)	**(25,477)**	(16,739)
Proceeds from sale of investment properties	**16,775**	50
Proceeds from sale of capital assets	**-**	1
Investment property additions	**(24,279)**	(29,663)
Capital asset additions	**(74)**	(104)
	(33,055)	(46,455)
Cash Flows From (Used In) Financing Activities		
Bank operating loan	**13,573**	5,859
Bank loans on land purchased (Note 9)	**16,333**	11,540
Repayment of debt on land inventory (Note 9)	**(24,243)**	(14,408)
Proceeds from investment property financing	**28,244**	35,818
Repayment of debt on investment properties	**(7,807)**	(2,342)
Dividends	**(9,299)**	(7,660)
Share capital issued (Note 12 (a))	**766**	2,162
Common shares purchased (Note 12 (a))	**-**	(3,286)
	17,567	27,683
Increase (decrease) in cash and cash equivalents during the year	**2,543**	2,870
Cash and cash equivalents, beginning of the year	**9,021**	6,151
Cash and cash equivalents, end of the year	**11,564**	9,021

1. Accounting Policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The precise determination of many assets and liabilities is dependent upon future events. Accordingly, the preparation of financial statements for a reporting period necessarily involves the use of estimates and approximations which have been made using careful judgement. Significant areas requiring the use of management estimates relate to the determination of the provision for land development costs and potential impairment of assets. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

a) Basis of consolidation

These consolidated financial statements include:

(i) The accounts of Melcor Developments Ltd. and its wholly-owned subsidiary companies (the "Company"):
Melcor Developments Arizona, Inc.
Melcor Lakeside Inc.
Stanley Investments Inc.

(ii) Investments in sixteen joint ventures (2005 – thirteen) are accounted for using the proportionate consolidation method.

b) Recognition of revenue

Revenue is recognized in each business segment as follows:

(i) Community Development – revenue from the sale of land is recognized when a minimum 15% of the sale price has been received, the sale is unconditional and possession has been granted.

(ii) Investment Property – rental revenue from properties is recognized over the term of the related lease agreement.

(iii) Recreation Property – revenue from golf courses is recognized as services are provided.

c) Capitalization of costs

(i) Community Development – The Company capitalizes all direct costs relating to land inventory including carrying costs such as property taxes, interest on debt specifically related to the project and other costs net of any rental income that may be received. Where the net realizable value of any property in land inventory does not exceed its capitalized carrying value, all additional carrying costs relating to the property are charged to current operations and are not capitalized. General administrative overhead expenses are not allocated and capitalized to properties.

(ii) Property Development and Investment Property – For acquired and constructed properties, building revenues and operating costs are capitalized as part of the cost of the property until the property is 75% occupied by tenants, subject to a reasonable period dependent on the nature of the property.

d) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired. These items are carried at cost or amortized cost as appropriate.

e) Land inventory

Land inventory is recorded at the lower of cost and net realizable value and includes undeveloped land costs, capitalized carrying costs related to holding the land and development costs to build infrastructure. The estimated unexpended portion of costs to complete building the infrastructure, which are classified as "Provision for land development costs", are recorded as a liability at the time that a lot sale is recorded. Whenever this liability is known to be materially different from the actual costs expected to be incurred, an adjustment is made to the liability with a corresponding adjustment to cost of sales. The cost of land and carrying costs are allocated to each phase of development on a prorated acreage basis at the time a plan is registered with a municipality. The cost of sale of a lot is allocated on the basis of the estimated total cost of the project prorated by anticipated selling price of the lot over the anticipated selling price of the entire project at the date of plan registration.

f) Investment properties

Commercial properties and the manufactured home community are amortized using the straight line method based upon an estimated useful life of 40 to 60 years. Golf courses and related assets are amortized using the straight line method based upon their estimated useful lives at rates from 4% to 30%.

g) Capital assets

Capital assets are amortized using the declining balance method of amortization, over their estimated useful lives, at rates from 10% to 30%.

h) Deferred costs and other assets

Deferred costs and other assets includes prepaid expenses, sundry assets, tenant leasing costs and those major repairs which are recoverable from tenants. These assets are amortized on a straight line basis over the estimated useful lives or lease period and are recorded at the lower of cost less accumulated amortization and net realizable value.

i) Impairment of long lived assets

Long lived assets include investment properties, capital assets and tenant leasing costs. An impairment is recognized when the carrying value of an asset exceeds the total undiscounted cash flows expected from its use and eventual disposition. The impairment recognized, is measured as the amount by which the carrying value exceeds its fair value.

j) Income taxes

Future income taxes are recognized at substantively enacted tax rates for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the date of substantial enactment.

k) Foreign currency translation

The Company's foreign operation is of a self-sustaining nature. Assets and liabilities of the foreign operation are translated at the exchange rates in effect at the balance sheet date and revenues and expenses are translated at average exchange rates for the year. Gains or losses on translation are shown as a separate component of shareholders' equity.

l) Per share amounts

The Company uses the treasury stock method for calculation of diluted earnings per share under which deemed proceeds from the exercise of options are considered to be used to reacquire common shares at an average share price.

m) Stock option plan

The Company uses the fair value based method of accounting for stock options issued to employees. Under this method, the estimated fair value of options on the date of grant is recognized as compensation expense over the period in which the employee services are rendered.

2. Changes In Accounting Policies And Estimates

Comprehensive Income, Equity & Financial Instruments – Recognition and Measurement:

The Accounting Standard Board of the Institute of Chartered Accountants of Canada issued Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges" and Section 1530, "Comprehensive Income" for annual and interim periods for fiscal years beginning on or after October 1, 2006.

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and the measurement of such amount. It also specifies how financial instrument gains and losses are to be presented. Section 3865 is applicable for designated hedging relationships and builds on existing Canadian GAAP guidance by specifying how hedge accounting is applied and what disclosures are necessary when it is applied. Section 1530 introduces new standards for the presentation and disclosure of components of comprehensive income. Comprehensive income is defined as the change in net assets of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in net assets during a period except those resulting from investments by owners and distributions to owners.

The Company is not expecting a material effect on the financial position or the results of operations due to the initial adoption of these recommendations in fiscal 2007.

Conditional Asset Retirement Obligations:

During the year, the Company applied the interpretations of the Canadian Institute of Chartered Accountants Emerging Issues Committee Abstract 159 "Conditional Asset Retirement Obligations" (EIC-159). Under EIC-159, a liability should be recognized if the entity has sufficient information to reasonably estimate the fair value of the asset retirement obligation. The Company has determined that it has a conditional asset retirement obligation relating to the removal of asbestos in one of its commercial properties. The Company believes that there is insufficient information to estimate the fair value of the asset retirement obligation because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique. For example, there are no plans to undertake a major renovation that would require removal of asbestos or demolition of the property. The property is expected to be maintained by repairs and maintenance activities that would not involve the removal of asbestos. Also, the need for major renovations caused by operational changes or other factors has not been identified.

3. Agreements Receivable

Agreements receivable are due within one year except for $20,500,000 (2005 – $27,000,000 due in 2007) which is due in 2008. Subsequent to the interest adjustment date, which provides an interest relief period of three months to qualifying registered builders, these receivables earn interest at prime plus two percent (8.00% at December 31, 2006 and 6.00% at December 31, 2005) and are secured by the specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region.

4. Land Inventory

($000s)	2006	2005
Undeveloped land and carrying costs	**161,774**	123,599
Pre-development costs	**34,596**	29,579
Developed land inventory cost	**59,200**	48,220
	255,570	201,398

During the year the Company purchased land in the amount of $55,349,000 (2005 - $29,774,000) and received vendor financing in the amount of $29,872,000 (2005 - $13,035,000).

5. Investment Properties

($000s)			2006			2005
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Commercial properties	**91,023**	**(9,898)**	**81,125**	76,953	(8,128)	68,825
Properties under development	**19,839**	**-**	**19,839**	8,789	-	8,789
Manufactured home community and related assets	**3,493**	**(552)**	**2,941**	3,493	(485)	3,008
Golf courses and related assets	**11,861**	**(3,336)**	**8,525**	9,231	(3,168)	6,063
	126,216	**(13,786)**	**112,430**	98,466	(11,781)	86,685

6. Capital Assets

($000s)			2006			2005
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Computerware and furniture	**1,027**	**(698)**	**329**	985	(664)	321
Other buildings and equipment	**31**	**(29)**	**2**	31	(25)	6
	1,058	**(727)**	**331**	1,016	(689)	327

7. Deferred Costs And Other Assets

($000s)	2006	2005
Tenant leasing costs	**6,509**	6,048
Major repairs	**3,151**	2,305
Sundry prepaids	**240**	173
Sundry inventory	**258**	251
	10,158	8,777

The Company paid tenant leasing costs of $1,917,000 during the year (2005 – $2,506,000) and amortized $1,456,000 (2005 – $1,145,000) of tenant leasing cost against respective lease revenues.

During the year, the Company incurred $1,302,000 in major repairs recoverable from tenants (2005 – $830,000) and amortized $456,000 (2005 – $333,000) into building operating costs.

8. Bank Operating Loan

The Company has an available credit facility with approved loan limits of $61,800,000 (2005 – $43,250,000) with a major chartered bank. The portion of these loan limits that pertain solely to the Company is $45,000,000 with the remaining balance pertaining to specific joint ventures.

The amount of the total credit facilities currently used is $29,599,000 (2005 – $16,026,000). The Company has pledged agreements receivable, specific lot inventory and a general security agreement as collateral for it's credit facility. This facility may be terminated by the bank upon one year's notice. Interest is paid monthly at rates varying from prime plus 0.5% to prime plus 1.0% (6.50% – 7.00% at December 31, 2006 and 5.50% – 6.00% at December 31, 2005).

9. Debt On Land Inventory

($000s)	2006	2005
Agreements payable with interest at the following rates:		
Fixed rates of 4.0% - 6.25%	**51,051**	35,822
Variable rates of prime plus 1.0% to prime plus 1.25% (7.00% - 7.25% at Dec. 31/06 and 6.00% - 6.25% at Dec. 31/05)	**21,389**	14,656
	72,440	50,478

During the year, the Company received vendor financing on land purchases of $29,872,000 (2005 – $13,035,000), obtained bank financing of $16,333,000 (2005 – $11,540,000) and made debt repayments of $24,243,000 (2005 – $14,408,000).

Specific land inventory with a book value of $136,245,000 (2005 – $85,283,000) has been pledged as collateral for the above debt. The weighted average interest rate of agreements payable, based on year end balances, is 5.5% (2005 – 4.9%).

The agreements mature from 2007 to 2016 and the minimum principal payments due within each of the next five years are as follows: 2007 – $15,750,000; 2008 – $23,915,000; 2009 – $10,022,000; 2010 – $7,098,000; 2011 – $4,131,000.

10. Debt On Investment Properties

($000s)	2006	2005
Mortgage amortized over 15 years with interest at prime plus 1.25% (7.25% at Dec. 31/06 and 6.25% at Dec. 31/05)	**1,284**	1,438
Project loan, maturing Dec. 2007, with interest at prime plus 0.25% (6.25% at Dec. 31/06)	**9,394**	-
Mortgages amortized over 15 to 25 years at fixed rates varying from 4.80% - 7.53% (2005 – 4.80% - 7.53%)	**79,191**	67,994
	89,869	69,432

Specific real estate with a net book value of $94,069,000 (2005 – $69,829,000) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above debt. The weighted average interest rate for mortgages, based on year end balances, is 5.7% (2005 – 5.8%).

Principal payments due within each of the next five years, assuming renewal at similar terms are: 2007 – $2,457,000; 2008 – $2,650,000; 2009 – $2,622,000; 2010 – $2,776,000; 2011 – $2,940,000.

Principal payments due within each of the next five years assuming no renewal are: 2007 – $14,667,000; 2008 – $10,276,000; 2009 – $2,403,000; 2010 – $16,724,000; 2011 – $7,544,000.

11. Future Income Taxes

($000s)	2006	2005
Investment property book values in excess of tax values	**4,607**	3,991
Reserve on amounts due in subsequent years	**15,945**	9,948
Interest and other costs deducted for tax purposes	**1,155**	1,159
Tenant leasing costs	**3,037**	2,627
	24,744	17,725

The reversal of future income taxes is primarily dependent upon the timing of development and sale of the related assets and on the timing of the receipt of cash relating to agreements receivable. Income taxes paid during the year were $19,642,000 (2005 – $4,678,000). Income tax expense is calculated as follows:

($000s)	2006	2005
Income tax at statutory rate (2006 – 32.49%; 2005 – 33.62%)	**26,843**	20,832
Increase (decrease) resulting from:		
Benefit recorded for Capital Gains realized during the year	**(1,991)**	–
Benefit recorded for expected future tax rate reductions	**–**	(680)
Non deductible expenses and other	**(3)**	33
Income tax expense	**24,849**	20,185

12. Share Capital

a) Common Shares

	2006		2005	
	Number of Shares Issued	**Amount ($000's)**	Number of Shares Issued	Amount ($000's)
Common shares, beginning of the year	**30,755,620**	**10,023**	30,545,030	8,024
Share options exercised	**300,100**	**766**	830,590	2,162
Shares purchased and cancelled	**–**	**–**	(620,000)	(163)
Common shares, end of the year	**31,055,720**	**10,789**	30,755,620	10,023

Authorized:	
Common shares	100,000,000
First Preferred Shares, non-voting	50,000,000

On April 12, 2006, the Shareholders of the Company approved a 10-for-1 division of the Company's share capital. As a result, all holders of common shares of record on May 1, 2006 received nine additional common shares for every one common share held and the authorized share capital of the Company was increased by 9 shares for every share that was previously authorized. Accordingly, all references to share capital and per share amounts, have been restated to reflect the 10-or-1 division of shares.

During the year, the Company announced that a Notice of Intention to make a Normal Course Issue Bid had been filed with the Toronto Stock Exchange to purchase up to 1,550,000 of its issued and outstanding common shares during the twelve month period commencing September 17, 2006. This bid will terminate on the earliest of the 17th day of September, 2007 or the date on which the maximum number of common shares are purchased pursuant to the Issuer Bid.

Purchases of common shares under the Issuer Bid must be effected through the facilities of the Toronto Stock Exchange. All Common Shares so purchased shall be immediately returned to the status of authorized but unissued capital.

The Bid that was in place from September 14, 2005 to September 15, 2006 expired with the Corporation not purchasing any common shares during the course of that Issuer Bid.

During the prior year (first quarter of 2005), the company purchased 620,000 shares pursuant to the Issuer Bid in place at that time, at an average price of $5.30 per share for total consideration of $3,286,000.

b) Stock Option Plan

On September 28, 2000 the Company's Board of Directors approved a stock option plan ("the Plan"). Under the Plan, the Company may grant stock options to full-time salaried employees and designated contractors after one year of service. The plan requires that the option price shall not be less than the weighted average trading price for the 20 consecutive days during which shares traded on the TSX immediately prior to the granting of the stock option. The stock options vest at 20% per year and expire seven years from the date of issuance and may be exercised into common shares on a one-for-one basis.

c) Stock Options Available for Granting

	2006	2005
Stock options available, beginning of the year	**104,800**	330,400
Stock options granted	**(53,600)**	(232,000)
Stock options forfeited	**8,000**	6,400
Stock options available, end of the year	**59,200**	104,800

The Company has 1,021,310 common shares reserved for issuance under the plan (2005 – 1,321,410).

d) Stock Options Outstanding Under the Plan

	2006		2005	
	Number of Options	**Weighted Average Option Price**	Number of Options	Weighted Average Option Price
Stock options outstanding, beginning of the year	**1,216,610**	**3.856**	1,821,600	2.870
Stock options granted	**53,600**	**16.600**	232,000	7.064
Stock options exercised	**(300,100)**	**2.550**	(830,590)	2.604
Stock options forfeited	**(8,000)**	**7.064**	(6,400)	1.873
Stock options outstanding, end of the year	**962,110**	**4.947**	1,216,610	3.856

e) Stock Options Outstanding and Exercisable Under the Plan

Stock Option Expiry Date	Outstanding Stock Options (#)	Stock Option Price Per Share ($)	Stock Option Exerciseable at Dec. 31, 2006
September 28, 2007	54,410	1.873	54,410
July 26, 2008	7,000	2.428	7,000
July 25, 2009	29,200	3.858	9,600
October 25, 2009	550,000	3.530	390,000
December 12, 2009	10,200	3.495	4,000
October 28, 2010	43,400	3.930	6,200
July 27, 2011	9,600	4.624	2,400
July 26, 2012	204,700	7.064	27,100
July 27, 2013	53,600	16.600	-
	962,110		500,710

f) Stock-Based Compensation Expense

The following weighted-average assumptions were used in the Black-Scholes calculations for stock options granted:

	2006	2005
Annualized volatility	**20%**	16%
Risk-free interest rate	**3.27%**	3.27%
Annual dividend rate	**2.41%**	2.55%
Expected life of options in years	**5**	5

The fair value of stock options granted during the year was $2.870 per stock option (2005 – $0.892), which resulted in a $120,000 (2005 – $78,000) charge to stock-based compensation expense and with a corresponding credit to contributed surplus.

13. Currency Translation Adjustment

($000s)	2006	2005
Cumulative unrealized gain/(loss) at the beginning of the year	**(831)**	(548)
Unrealized gain/(loss) for the year on the translation of net assets	**224**	(283)
	(607)	(831)

This adjustment represents the net unrealized foreign currency translation gain (loss) on the Company's net investment in its self-sustaining foreign operation.

14. Per Share Amounts

(#)	**2006**	2005
Basic weighted average common shares outstanding during the year	**30,909,314**	30,279,810
Dilutive effect of options	**698,245**	671,240
Diluted weighted average common shares	**31,607,559**	30,951,050

Basic net earnings per share is calculated by dividing the Company's net earnings by the weighted average number of common shares outstanding during the year. Diluted earnings per common share is calculated to give dilutive effect to share options.

15. Financial Guarantees

In the normal course of operations, the Company issues letters of credit as security for the completion of obligations pursuant to development agreements signed with municipalities. At December 31, 2006 the Company had $30,516,000 (December 31, 2005 – $22,939,000) in letters of credit outstanding and recorded a net liability of $39,805,000 (December 31, 2005 – $29,026,000) in provision for land development costs in respect of these development agreements.

Normally, obligations secured by the letters of credit diminish as the developments proceed, through a series of staged reductions over a period of years (average of three to four years) and are ultimately extinguished when the municipality has issued final completion certificates.

The Company enters into joint venture agreements and, in doing so, may take on risk beyond its proportionate interest in the joint venture. These situations generally arise where preferred financing terms can be arranged on the condition that the strength of the Company's covenant will backstop that of the other joint venture participant(s) who also provide similar guarantees. The Company will have to perform on its guarantee only if a joint venture participant was in default of their guarantee. At December 31, 2006 the Company had guaranteed $6,169,000 (2005 – $11,264,000) in loans and $6,350,000 (2005 – $5,300,000) in letters of credit in support of other participant's interests. The loan guarantees include those which are ongoing, as they relate to the relevant lines of credit, and those which have staged reductions as they relate to the financing of specific assets or projects such as infrastructure loans, short-term land loans or mortgages.

To mitigate the possibility of financial loss, the Company is diligent in its selection of joint venture participants. As well, the Company has remedies available within the joint venture agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint venture participants.

16. Interest Expense

($000s)	2006	2005
Interest on bank operating loan	**2,426**	804
Interest on debt – land inventory	**2,741**	1,934
Interest on debt – investment properties	**4,001**	3,092
	9,168	5,830
Less interest on land inventory debt capitalized	**(2,741)**	(1,934)
	6,427	3,896

Cumulative interest capitalized on land inventory at the end of the year is $8,612,000 (2005 – $7,476,000). Interest paid during the year was $8,560,000 (2005 – $5,665,000).

17. Interest Rate Risk

The Company's debt consists of loans that are subject to interest rate fluctuations. For each 1% change in the rate of interest on loans subject to floating rates, the change in annual interest expense is approximately $590,000 (2005 - $321,000) based upon year end debt balances. This amount is partially offset by the interest earned on agreements receivable which is also subject to interest rate fluctuations.

18. Joint Ventures

					Cash Flows From (Used In)		
($000s)	Assets	Liabilities	Revenue	Earnings	Operating Activities	Investing Activities	Financing Activities
2006	**120,963**	**56,045**	**55,572**	**17,157**	**24,651**	**(18,232)**	**(5,241)**
2005	108,036	57,849	45,666	14,266	12,882	(6,113)	(346)

The above table includes the Company's proportionate share of the assets, liabilities, revenue, earnings and cash flow information of sixteen joint ventures (2005 – thirteen) that are proportionately consolidated in these financial statements. The Company's proportionate interest of these joint ventures ranges from 30% – 75% ownership.

19. Segmented Information

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business unit requires different management skills and marketing strategies The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

In the following schedules, earnings from operations before income tax expense has been calculated for each segment by deducting from revenues of the segment all direct costs and administrative expenses which can be specifically attributed to the segment, as this is the basis for measurement of segment performance. Common costs, which have not been allocated, are the costs of corporate debt and general corporate expenses. The allocation of these costs on an arbitrary basis to the segments would not assist in the evaluation of the segments' contributions.

Inter-segment transactions are entered into under terms and conditions similar to those with unrelated third parties. Any inter-segment sales and the unrealized profits therefrom, have been eliminated.

Community Development

This division is responsible for purchasing and developing land to be sold as residential, industrial and commercial lots.

Property Development

This division develops investment properties which, when constructed and at least 75% leased, are transferred to the Investment Property Division which will hold and manage the asset. The transfer is at the Company's estimate of fair value and is recorded as revenue in the Property Development Division.

Investment Property

This division owns 25 properties (2005 – 23 properties), which it holds to earn rental income.

Recreation Property

This division owns and manages two 18-hole golf course operations (one of which is 60% owned) and owns a golf course under construction.

The community development segment includes the operations of its wholly owned subsidiary in the United States. A summary of its activities are as follows:

($000s)	2006	2005
External revenue	**1,085**	4,191
Earnings	**799**	940
Interest Income	**296**	173
Assets	**9,092**	8,286
Equity	**8,770**	7,747

Other Segmented Information

($000s)	Amortization		Capital Expenditures		Total carrying value of identifiable assets	
	2006	2005	2006	2005	2006	2005
Community development	**3**	3	**-**	-	**383,895**	288,387
Property development	**-**	-	**11,672**	9,583	**20,941**	8,324
Investment property	**1,848**	1,375	**9,803**	16,505	**94,030**	80,943
Recreation property	**333**	244	**2,804**	3,575	**8,732**	6,238
Common	**56**	60	**74**	104	**15,329**	12,221
	2,240	1,682	**24,353**	29,767	**522,927**	396,113

	For the year ended December 31, 2006			For the year ended December 31, 2005		
Revenue ($000s)	Segment Revenue	Inter-segment Eliminations	External Revenue	Segment Revenue	Inter-segment Eliminations	External Revenue
Community development	**183,581**	**(4,990)**	**178,591**	149,246	(6,225)	143,021
Property development	**13,638**	**(10,980)**	**2,658**	9,392	(9,301)	91
Investment property	**19,765**	**(503)**	**19,262**	15,749	(479)	15,270
Recreation property	**3,026**	**(135)**	**2,891**	3,228	(110)	3,118
	220,010	**(16,608)**	**203,402**	177,615	(16,115)	161,500

Earnings ($000s)	**Segment** Earnings	**Inter-segment** Eliminations	**External** Earnings	Segment Earnings	Inter-segment Eliminations	External Earnings
Community development	**78,630**	**(2,829)**	**75,801**	66,566	(2,881)	63,685
Property development	**1,589**	**(1,515)**	**74**	2,093	(2,250)	(157)
Investment property	**13,999**	-	**13,999**	2,279	-	2,279
Recreation property	**89**	-	**89**	646	-	646
	94,307	**(4,344)**	**89,963**	71,584	(5,131)	66,453
Non-allocated items:						
Interest income			**294**			416
Interest expense			**(1,422)**			(389)
General and administrative expenses			**(6,215)**			(4,519)
Earnings before income tax expense			**82,620**			61,961
Income tax expense			**(24,849)**			(20,185)
Net earnings for the year			**57,771**			41,776

Interest ($000s)	**Per Segment**	**Inter-segment Eliminations**	**Per Financial Statement**	Per Segment	Inter-segment Eliminations	Per Financial Statement
Interest Income:						
Community development	**4,109**	-	**4,109**	1,449	-	1,449
Property development	-	-	-	-	-	-
Investment property	**36**	-	**36**	22	-	22
Recreation property	-	-	-	-	-	-
Non-allocated	**315**	**(21)**	**294**	469	(53)	416
	4,460	**(21)**	**4,439**	1,940	(53)	1,887
Interest Expense:						
Community development	**(935)**	**21**	**(914)**	(468)	53	(415)
Property development	-	-	-	-	-	-
Investment property	**(3,811)**	-	**(3,811)**	(2,914)	-	(2,914)
Recreation property	**(280)**	-	**(280)**	(178)	-	(178)
Non-allocated	**(1,422)**	-	**(1,422)**	(389)	-	(389)
	(6,448)	**21**	**(6,427)**	(3,949)	53	(3,896)

20. Fair Value Of Financial Instruments

Financial instruments consists of cash and cash equivalents, accounts receivable, agreements receivable, bank operating loan, income taxes payable, accounts payable and accrued liabilities, debt on land inventory, and debt on investment properties. The Company believes that the fair value of financial instruments approximates their carrying values. The fair value of cash and cash equivalents, accounts receivable, bank operating loan, income taxes payable, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature.

The fair value of agreements receivable are estimated based on the interest bearing nature of these instruments which are at rates consistent with market rates for debt instruments with similar terms to maturity. The fair value of debt on land inventory and debt on investment properties are estimated based on quoted market rates for similar instruments with similar terms.

21. Definitions For Statements Of Cash Flows

Development activities is defined as the net change of land inventory and the provision for land development costs and excludes the purchase of land inventory and the amount related to the application of the current rate method of translation of the US subsidiary, which is an increase of $224,000 (2005 – a decrease of $283,000). Purchase of land inventory is the cost of land net of vendor financing received (see Note 4 – Land Inventory).

Operating assets and liabilities is defined as the net change of accounts receivable, deferred costs and other assets, income taxes payable, accounts payable and accrued liabilities.

Management's Responsibility for Financial Reporting

The Annual Report, including the consolidated financial statements, is the responsibility of the management of the Company. The financial statements have been prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants in all material respects. Financial information contained elsewhere in this Report is consistent with the information contained in the financial statements.

Management maintains a system of internal controls which provides reasonable assurance that the assets of the Company, its subsidiaries and joint ventures are safeguarded and which facilitates the preparation of relevant, timely and reliable financial information which reflects, where necessary, management's best estimates and judgements based on informed knowledge of the facts.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities and for final approval of the consolidated financial statements. The Board has appointed an Audit Committee comprising at least three unrelated and independent directors to approve, monitor, evaluate, advise or make recommendations on matters affecting the external audit, the financial reporting and the accounting controls, policies and practices of the Company under its terms of reference.

The Audit Committee meets at least four times per year with management and with the independent auditors to satisfy itself that they are properly discharging their responsibilities. The consolidated financial statements and the Management Discussion and Analysis have been reviewed by the Audit Committee and approved by the Board of Directors of Melcor Developments Ltd.

PricewaterhouseCoopers LLP, independent external auditors appointed by the shareholders, have examined the consolidated financial statements and have read Management's Discussion and Analysis. Their report as auditors is set forth below.

Auditors' Report

To the Shareholders of Melcor Developments Ltd.

We have audited the consolidated balance sheets of Melcor Developments Ltd. as at December 31, 2006 and 2005 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Edmonton, Alberta
February 23, 2007

Five Year Review

Balance Sheet ($000s)	2006	2005	2004	2003	2002
Assets					
Cash and cash equivalents	**11,564**	9,021	6,151	5,080	7,105
Accounts receivable	**5,696**	4,570	2,908	2,336	2,914
Income taxes receivable	**-**	-	3,118	-	-
Agreements receivable	**127,178**	85,335	43,508	46,904	57,094
Land inventory	**255,570**	201,398	163,694	141,004	116,904
Investment properties	**112,430**	86,685	54,930	50,396	42,412
Capital assets	**331**	327	291	321	298
Deferred costs and other assets	**10,158**	8,777	7,748	5,661	5,068
	522,927	396,113	282,348	251,702	231,795

Liabilities and Shareholders' Equity	2006	2005	2004	2003	2002
Bank operating loan	**29,599**	16,026	10,167	1,642	839
Accounts payable and accrued liabilities	**26,563**	21,125	12,107	9,347	14,390
Income taxes payable	**3,997**	5,973	-	492	2,409
Provision for land development costs	**39,805**	29,026	18,962	15,072	13,763
Debt on land inventory	**72,440**	50,478	40,311	35,885	29,141
Debt on investment properties	**89,869**	69,432	35,956	37,335	31,170
Future income taxes	**24,744**	17,725	11,304	11,192	13,572
Share capital	**10,789**	10,023	8,024	7,523	6,946
Retained earnings	**225,121**	176,305	145,517	133,214	119,565
	522,927	396,113	282,348	251,702	231,795

Statement of Earnings ($000s)	2006	2005	2004	2003	2002
Revenue	**203,402**	161,500	88,339	80,035	110,565
Cost of sales	**(115,886)**	(86,343)	(52,107)	(46,554)	(67,630)
	87,516	75,157	36,232	33,481	42,935
Interest income	**4,439**	1,887	1,586	2,389	1,716
Interest expense	**(6,427)**	(3,896)	(2,463)	(2,363)	(1,530)
General and administrative expenses	**(11,786)**	(9,442)	(5,546)	(6,493)	(7,156)
Depreciation expense	**(2,240)**	(1,682)	(1,486)	(1,091)	(906)
	71,502	62,024	28,323	25,923	35,059
Gain/(loss) on sale of investment properties	**11,118**	(63)	-	1,578	1,004
Earnings before income tax expense	**82,620**	61,961	28,323	27,501	36,063
Income tax expense	**(24,849)**	(20,185)	(8,886)	(9,095)	(12,974)
Net earnings for the year	**57,771**	41,776	19,437	18,406	23,089

Statistical ($)		2006	2005	2004	2003	2002
Earnings per share	- basic	**1.87**	1.38	0.63	0.60	0.76
Earnings per share	- diluted	**1.83**	1.35	0.62	0.59	0.74
Number of shares	- year end (000s)	**31,056**	30,756	30,545	30,828	30,521
Shareholders equity	- book value per share	**7.60**	6.06	5.03	4.57	4.15
	- total ($000s)	**235,910**	186,328	153,541	140,737	126,511
Dividends	- per share	**0.30**	0.25	0.12	0.11	0.10
Share price range	- per share	**11.50-22.25**	5.10-12.00	4.45-5.50	3.70-4.80	2.65-4.25

Melcor 2006 Performance Measures (Selected)

	2002	% change	2003	% change	2004	% change	2005	% change	**2006**
Assets ($000s)	231,795		251,806		282,348		396,113		**522,927**
Average annual increase = 31.4%		8.6%		12.1%		40.3%		32.0%	
Shareholders' Equity ($000s)	126,511		140,737		153,541		186,328		**235,910**
Average annual increase = 21.6%		11.2%		9.1%		21.4%		26.6%	
Revenue ($000s)	110,565		80,035		88,339		161,500		**203,402**
Average annual increase = 21.0%		-27.6%		10.4%		82.8%		25.9%	
Gross Margin	38.8%		41.8%		41.0%		46.5%		**43.0%**
Five year average = 42.8%									
Admin. Expenses/Revenue	6.5%		8.1%		6.3%		5.8%		**5.8%**
Five year average = 6.3%		24.6%		-22.2%		-7.9%		0.0%	
Earnings Before Taxes ($000s)	36,063		27,501		28,323		61,961		**82,620**
Average annual increase = 32.3%		-23.7%		3.0%		118.8%		33.3%	
Basic Earnings Per Share ($)	0.76		0.60		0.63		1.38		**1.87**
Average annual increase = 36.5%		-21.1%		5.0%		119.0%		35.5%	
Average Share Price ($)	3.66		4.02		4.85		8.50		**17.90**
Average annual increase = 97.3%		9.8%		20.6%		75.3%		110.6%	
Dividend ($)	0.10		0.11		0.12		0.25		**0.30**
Average annual increase = 50.0%		10.0%		9.1%		108.3%		20.0%	
Dividend Yield	2.7%		2.7%		2.5%		2.9%		**1.7%**
Five year average = 2.3%									
Book Value Per Share ($)	4.15		4.57		5.03		6.06		**7.60**
Average annual increase = 20.8%		10.1%		10.1%		20.5%		25.4%	
Average Book Value Per Share ($)	3.83		4.36		4.80		5.55		**6.83**
Average annual increase = 19.6%		14.0%		10.1%		15.5%		23.2%	
Avg. Market/Avg. Book	0.96		0.92		1.01		1.53		**2.62**
Five year average = 1.54									
Price Earnings Ratio	4.8		6.7		7.7		6.2		**9.6**
Five year average = 7.4									
Return On Equity	19.8%		13.8%		13.2%		24.6%		**27.4%**
Five year average = 20.6%									
Return On Assets	11.3%		7.6%		7.3%		12.3%		**12.6%**
Five year average = 10.6%									
Debt/Equity Ratio	0.83		0.79		0.84		1.13		**1.22**
Five year average = 1.00									
Asset Turnover	54.1%		33.1%		33.1%		47.6%		**44.3%**
Five year average = 42.6%									

Calculations:

Price Earnings Ratio is the average share price for the year divided by the basic earnings per share for that year.

Return on Equity is the net earnings after income tax expense for the year divided by the average equity during the year.

Return on Assets is the net earnings after income tax expense for the year divided by the average assets during the year.

Corporate Information

Corporate Office

900, 10310 Jasper Avenue
Edmonton, Alberta T5J 1Y8
(780) 423-6931
info@melcor.ca
www.melcor.ca

Directors

William D. Grace (1) (2)
Corporate Director
Edmonton, Alberta

W. Garry Holmes (1)
Corporate Director
Edmonton, Alberta

Lou D. Hyndman (1) (2)
Counsel
Field LLP,
Barristers & Solicitors
Edmonton, Alberta

Andrew J. Melton
Partner
Avison Young Commercial Real Estate
Calgary, Alberta

Timothy C. Melton
Executive Chairman
Melcor Developments Ltd.
Edmonton, Alberta

Bruce Saville (2)
President
Saville Interest Group Inc.
Edmonton, Alberta

Ross A. Grieve (1) (2)
President & CEO
PCL Construction Group Inc.
Edmonton, Alberta

Ralph B. Young
President & Chief
Executive Officer
Melcor Developments Ltd.
Edmonton, Alberta

Notice of Annual Meeting

The annual meeting of Shareholders will be held at The Fairmont Hotel Macdonald, Wedgwood Room, 10065-100 Street, Edmonton, Alberta, Canada on the 19th day of April, 2007 at 11:00 am MDT.

(1) Audit Committee
(2) Governance Committee
(3) Management Committee

Executive Officers

Timothy C. Melton (3)
Executive Chairman

Ralph B. Young (3)
President & Chief Executive Officer

Michael D. Shabada (3)
Vice-President, Finance and
Chief Financial Officer

Brett A. Halford (3)
Vice-President, Administration

W. Peter Daly (3)
Vice-President,
Community Development Division

Community Development

Edmonton Region

900, 10310 Jasper Avenue
Edmonton, Alberta T5J 1Y8
(780) 423-6931

W. Peter Daly
Vice-President,
Community Development Division

Calgary Region

204, 400 Crowfoot Crescent N.W.
Calgary, Alberta T3G 5H6
(403) 283-3556

Bill Hodgson
Vice-President and Regional Manager

Red Deer Region

502 Parkland Square
Red Deer, Alberta T4N 6M4
(403) 343-0817

Guy Pelletier
Vice-President and Regional Manager

Lethbridge Region

1425-33 Street N
Lethbridge, Alberta T1H 5H2
(403) 328-0475

Neil Johnson
Vice-President and Regional Manager

Kelowna Region

230, 1855 Kirscher Rd.
Kelowna, BC V1Y 4N7
(250) 717-8390

Randy Sieben
Vice-President and Regional Manager

Property Development

900, 10310 Jasper Avenue
Edmonton, Alberta T5J 1Y8
(780) 423-6931

Brian Baker
Vice-President,
Property Development Division

Investment Property

Commercial Property

900, 10310 Jasper Avenue
Edmonton, Alberta T5J 1Y8
(780) 423-6931

Darin Rayburn
Vice-President,
Investment Property Division

Watergrove Manufactured Home Community

400, 99 Arbour Lake Road NW
Calgary, Alberta T3G 4E4
(403) 547-0200

Doug Alton
Manager

Golf Courses

The Links At Spruce Grove

P.O. Box 4268
Spruce Grove, Alberta T7K 3B4
(780) 962-4653

Pierre Beauchemin
Pro/Manager

Glen Andersen
Superintendent

Lewis Estates Golf Course

8700 - 207 Street
Edmonton, Alberta T5T 6A4
(780) 489-1369

Jerry Linquist
Pro/Manager

Rob Sklaruk
Superintendent

Finance and Administration

Karen Albarda
Operations Controller

Jon Goor
Corporate Controller

Other Information

Share Transfer Agent:
CIBC Mellon Trust Company, Calgary & Toronto
Stock Exchange Listing:
The Toronto Stock Exchange (Stock symbol: MRD)
Auditors: PricewaterhouseCoopers LLP,
Chartered Accountants, Edmonton

Melcor Builds

MELCOR
DEVELOPMENTS LTD.